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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

In the Matter of
PITTSBURGH RAILWAYS COMPANY, Debtor.

NO. 1178

PHILADELPHIA COMPANY, Petitioner,
v.
JULES GUGGENHEIM, et al.

NO. 1179

PHILADELPHIA COMPANY, Petitioner,
v.
JULES GUGGENHEIM, et al.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF.

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SUBJECT INDEX

	PAGE
Petition for Writs of Certiorari	1
Statement of Case	2
Jurisdiction	8
Question Presented	8
Reasons for Granting the Writs	9
Conclusion	13
Brief in Support of Petition	15
Opinions Below	15
Jurisdiction	15
Statement of the Case	15
Specification of Error	16
Argument	16
Summary	16
The Identity of Persons Who Would Profit By Subordination Should be Investigated	17
Counter-Equities Against the Persons Who Would Profit By Subordination Should Be Investigated	19
a. Time of Acquisition of Claims	20
b. Notice of Laches and Estoppel	21
c. Cost of Acquisition	26
The Authorities Relied Upon By the Circuit Court Are Not In Point	30

TABLE OF AUTHORITIES

CASES: PAGE

American Brake Shoe & Foundry Co. v. Interborough R. Transit Co., 112 F. 2d 669 (2 Cir., 1940) 24

American United Mut. Life Ins. Co. v. City of Avon Park, 311 U.S. 138, 61 S. Ct. 157 (1940) 29

re Associated Gas & Electric Co., 149 F. 2d 996 (2d Cir., 1945) 30

Belden v. Burke, 147 N.Y. 542, 42 N.E. 261 (1895) 23

Continental Trust Co. v. Toledo, St. L. & K. C. R. Co., 82 Fed. 642 (Circ. Ct. N.D. Ohio; 1897) 24

re Deep Rock Oil Corp., 113 F. 2d 266 (10 Cir., 1940) 31

re Deep Rock Oil Corp., 117 F. 2d 615 (10 Cir., 1941) 30, 31

DeWeese v. Reinhard, 165 U.S. 386, 17 S. Ct. 340 (1897) 24

Elias v. Clarke, 143 F. 2d 640 (2d Cir., 1944) 30

Erie Railroad v. Tompkins, 304 U.S. 64, 58 S. Ct. 817 (1938) 25

J. S. Farlee Co. v. Springfield South Main Realty Co., 86 F. 2d 931 (1 Cir., 1936) 28

Godfrey v. Powell, 150 F. 2d 486 (5 Cir., 1945) ..12, 23

Graham v. LaCrosse & M. R. R. Co., 102 U.S. 148, 26 L. Ed. 106 (1880) 24

Guaranty Trust Co. of New York v. Chicago M. & St. P. R. Co., 15 F. 2d 434 (N.D. Ill., 1926) ... 28

CASES: PAGE

Hawes v. Oakland, 104 U.S. 450, 26 L. Ed. 827 (1882) 25

Jencks v. Quidnick Co., 135 U.S. 457, 10 S. Ct. 655 (1890) 13, 27

Lorraine Castle Apartments Bldg. Corporation, Inc., 149 F. 2d 55 (7 Cir., 1945) 30

re McEwen's Laundry, 90 F. 2d 872 (6 Cir., 1937) 28

re Midland United Co., 58 F. Supp. 667, 681 (D.C. Del. 1944) 24

Mississippi & Missouri Railroad Co. v. Cromwell, 91 U.S. 643, 23 L. Ed. 367 (1876) 13, 28

re Missouri Pacific R. Co., 64 F. Supp. 64 (E.D. Mo., Dec. 21, 1945) 12, 23

Palmer v. Bankers' Trust Co., 12 F. 2d 747 (8 Cir., 1926) 28

re Pittsburgh Railways Company, 155 F. 2d 477 (3 Cir., 1946) 4

Standard Gas & Electric Co. v. Deep Rock Oil Corp., 117 F. 2d 615 (10 Cir., 1941) 30

Taylor v. Standard Gas & Electric Co., 306 U.S. 307, 59 S. Ct. 543 (1939) 2, 9, 31

STATUTES

PAGE

Bankruptcy Act, Chapter X:
Sect. 24(c), 11 U.S.C.A. 47 8
Sect. 121, 11 U.S.C.A. 521..... 8
Sect. 166, 11 U.S.C.A. 566..... 20
Sect. 167, 11 U.S.C.A. 567..... 19
Sect. 198, 11 U.S.C.A. 598..... 18
Sect. 203, 11 U.S.C.A. 603..... 20
Sect. 210, 11 U.S.C.A. 610..... 20
Sect. 211, 11 U.S.C.A. 611..... 20
Sect. 212, 11 U.S.C.A. 612..... 20

Judicial Code, Sec. 240(a), 28 U.S.C.A. 347..... 8

Pennsylvania Statutes:
Act of April 18, 1945, P. L. 253; 12 P.S. 1321-1323 25

MISCELLANEOUS

The Conflict of Equities Under the "Deep Rock" Doctrine, (Sprecher) 43 Columbia Law Review, 336 .....21, 22

Pomeroy's Equity Jurisprudence, 5th Ed., 1941—Vol 2, pp. 601-602..... 21

Rule 23 (b), Federal Rules of Civil Procedure..... 25

General Order in Bankruptcy No. 21(3)..... 29

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable Fred M. Vinson, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

The petitioner, Philadelphia Company, respectfully petitions this Honorable Court for writs of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

STATEMENT OF CASE.

In the reorganization proceedings of Pittsburgh Railways Company, in the District Court of the United States for the Western District of Pennsylvania, the Court directed, by Order dated November 7, 1945, an investigation for the purpose of determining whether the claims of Philadelphia Company, the parent and a creditor of the debtor, should be limited or subordinated under the so-called "Deep Rock" rule of *Taylor v. Standard Gas & Electric Company,* 306 U. S. 307, 59 S. Ct. 543 (1939). No appeal having been taken from the order of November 7, the Trustee's investigation has proceeded, but has not yet been completed.

The present case arises out of the efforts of Philadelphia Company to have the scope of the investigation broadened so as to determine the identity of the persons who would profit by the subordination of its claims and to determine whether there are any counter-equities against such persons. The facts relating to Philadelphia Company's efforts to broaden the scope of the investigation can best be understood in the light of the facts leading to the investigation of Philadelphia Company.

Proceedings Leading to Investigation of Philadelphia Company.

Pittsburgh Railways Company filed a voluntary petition for reorganization on May 10, 1938. A question concerning the status of its underlier or lessor companies having arisen, the City of Pittsburgh filed a petition, on October 23, 1942, seeking to have the Court assume jurisdiction over the underliers (R. 34 a). The case was referred to a Special Master, and the City's

evidence, covering in detail the history of the companies, was completed on March 17, 1943 (R. 34 a).

In the following month, April, 1943, Jules Guggenheim, *et al.*, a group of persons from New York and vicinity, began to acquire securities of Pittsburgh Railways Company and its underliers (R. 34 a). The purchase price of their securities was comparatively low, in contrast with the higher market prices of such securities which later materialized (R. 39 a). All of the securities held by this group were acquired between April, 1943 and November, 1944 (R. 34 a; 43 a-49 a). It must be noted, however, that Jules Guggenheim et al. are only a small portion of the Debtor's security-holders. The Court below, as we shall see, has declined to cause an investigation to ascertain whether similar facts are true with respect to other security-holders.

In December, 1944, Jules Guggenheim *et al.* filed a petition praying for the amendment of the Trustee's plan of reorganization, so as to subordinate the claims of Philadelphia Company (R. 35 a). The averments of the petition were to a large extent copied from the petition and brief of the City of Pittsburgh in the matter of the underlier companies, which was then still pending before the Special Master (R. 35 a).

In January, 1945, the Special Master filed his report, recommending the dismissal of the City's petition. After a full and complete review of the facts, the Master concluded, *inter alia,* that no wrongful acts appeared to have been committed by Philadelphia Company (R. 35 a).[1] The same conclusion was reached by the District Court.

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[1] Although the Circuit Court found, on appeal, that the Master's report was "full and complete and most

In June, 1945, the District Court granted a hearing on the petition of Guggenheim *et al.*, filed December 22, 1944, and notices were sent to all parties (R. 36 a). Shortly before the hearing, Guggenheim *et al.*, influenced, one may infer, by the fact that the Master had found that no mismanagement existed, amended the prayer of their petition so as to seek, not the outright subordination of Philadelphia Company as originally prayed for (R. 35 a), but rather an investigation by the Trustee to determine whether there existed grounds for such subordination (R. 36 a).

On November 7, 1945, after a hearing, the District Court granted the prayer of the Guggenheim petition (R. 14 a-19 a; 63 F. Supp. 7), and directed the Trustee of the debtor to conduct an examination under Sections 21a and 167 of the Bankruptcy Act "* * * for the purpose of inquiring into the matters described in the aforesaid petition of Jules Guggenheim *et al.*, as well as any other matters relating to possible claims or causes of action available to the estate against Philadelphia Company or any other party, and other grounds for the equitable limitation or subordination of claims filed by Philadelphia Company in this proceeding * * *." (R. 20 a).

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carefully done", it filed an opinion on May 7, 1946 reversing the District Court's decision, which had followed the Master's recommendation that the City's petition be dismissed. (In re Pittsburgh Rys. Co., 155 F. 2d 477). Certiorari was denied by this Court on October 14, 1946, ... U.S. .... 67 S. Ct. 89, 90. Nothing in the Circuit Court's opinion, however, is in derogation of the conclusion of the Master and the District Court that no wrongful acts appeared to have been committed by Philadelphia Company.

No appeal was taken from this order, and the Trustee's investigation has proceeded.

Efforts of Philadelphia Company to Broaden the Investigation.

Philadelphia Company moved promptly (on November 21, 1945, two weeks after the examination was ordered), to serve notice of a motion to enlarge the scope of the investigation to the following ends (R. 21 a, 22 a):

> "1. So as to cause the investigation to apply not only to Philadelphia Company, but to all holders of bonds, notes, securities or liabilities of the debtor, and
>
> "2. So as to cause the investigation to apply, not only to claims actually filed against the debtor, but to all notes, bonds, securities or liabilities of the debtor, whether or not claims have actually been filed thereon."

On January 21, 1946 the District Court refused the aforesaid motion (R. 29 a) and filed an opinion stating in part (R. 29 a; In re Pittsburgh Rys. Co., 64 F. Supp. 231):

> "If the investigation sought for will be of value hereafter, the Court can make such an order at any time upon presentation of proper facts in support thereof."

Philadelphia Company (although intending to file a petition stating the facts more fully), filed an appeal from the Order of January 21 and this appeal was before the Circuit Court at No. 9129, the District Court having extended the time for filing the record on appeal (R. 31 a). As the District Court was advised (R. 38 a)

the appeal at No. 9129 was taken merely as a cautionary measure to preserve Philadelphia Company's rights in the event that it should be contended that the Order of January 21, 1946 was *res adjudicata* with respect to a later petition on the same subject matter.

Such a later petition was filed on March 6, 1946 and is printed at pages 32(a) to 51(a) of the Record. In support of an enlargement of the investigation it sets forth among other things the following facts:

1. A majority of the public holders of bonds of the debtor have not filed claims in this proceeding. Such bondholders, however, may be entitled to participate in the benefits of the application of the "Deep Rock" rule by virtue of claims filed by indenture trustees, which do not disclose the identity of the bondholders on whose behalf they are filed.
2. There has been a large amount of trading in the publicly held securities of the debtor and a large number of securities have been purchased since the inception of the reorganization proceedings.
3. The extent and nature of the trading in securities of the debtor indicates that many of the present holders of obligations of the debtor are not bona fide purchasers for value but are charged with notice of all defenses against their securities, and are charged with notice of the acts which have been pointed to as a basis for the subordination of the claims of Philadelphia Company.
4. The trend of market prices of securities of the debtor indicates that many securityholders

> have acquired their securities at relatively low prices, that such securities have advanced to relatively high prices so that such security-holders are already in a position to make a large profit. This profit will be much larger and may be so large as to amount to an unjust enrichment if such securities are granted priority to the securities held by Philadelphia Company.

Not knowing the identity of most of the public securityholders, Philadelphia Company was unable to make more specific charges of fraud or counter-equities.

The prayer of the petition was the same as that of the motion filed November 21, 1945, previously described (*Supra*, p. 5). Notice of the petition was served on all parties in interest (R. 53 a).

At the hearing on its petition, Philadelphia Company offered to substantiate by evidence the facts averred therein (R. 79 a), but the Court chose not to receive such evidence (R. 68 a, 76 a) and dismissed the petition, by order dated May 1, 1946 (R. 81 a). It is the appeal from this order (No. 9163 in the Circuit Court) which was pressed by Philadelphia Company in the Circuit Court and which was there denied.

JURISDICTION.

The orders of the Circuit Court of Appeals were entered on December 31, 1946 (R. 85, 91, 92).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (28 U.S.C.A. 347). Section 240(a) is rendered applicable to appeals in bankruptcy reorganization proceedings by Section 121 of Chapter X (11 U.S.C.A. 521) which in turn makes reference to the Bankruptcy Act. (Sect. 24(c); 11 U.S.C.A. 47).

QUESTION PRESENTED.

In a corporate reorganization proceeding, where the Court has ordered an investigation to determine whether there are grounds for the equitable limitation or subordination of the claims of the parent corporation of the debtor, does the Court err when it refuses to broaden the scope of the investigation so as to determine (a) the identity of the persons who would profit by such limitation or subordination, and (b) whether there are counter-equities against such persons which should be taken into consideration in determining whether such persons are equitably entitled to profit by the limitation or subordination of the claims of the parent, and in determining whether such persons themselves might be subject to equitable limitation or subordination?

REASONS FOR GRANTING THE WRITS.

1. The Decision of the Circuit Court of Appeals Involves Important Questions of Law which have not been, but should be, Decided by this Court.

The decision of the Circuit Court deals with a question of great importance in the application of the so-called "Deep Rock" rule of *Taylor v. Standard Gas & Electric Company*, 306 U.S. 307, 59 S. Ct. 543 (1939). Pursuant to the "Deep Rock" rule, in corporate reorganization proceedings, the claims of a corporate parent may, in certain circumstances, be subordinated to the claims of public securityholders against the estate of a subsidiary. The importance of these cases stems from the fact that the amounts involved are large. Millions of dollars are involved in the present case. Hundreds of millions are involved in other cases of a similar nature.

With these huge amounts at stake, the decision of the Circuit Court denies to a corporate parent against whom charges of mismanagement are asserted, the right adequately to prepare a defense to the charges made against it. The corporate parent is denied the opportunity even to ascertain the identity of its adversaries, the securityholders who would benefit by the subordination of the parent's claims. The parent is unable, therefore, to take the first step towards preparing a defense or to ascertain whether there are counter-equities or counterclaims against these adversaries. It is compelled to stand by helpless to assert such defenses as further investigation might disclose, while the other securityholders proceed, with the aid of the Court and

at the expense of the estate, to try to build up a case against it.

The case derives further importance from the fact that the damage, once done to the corporate parent, is irreparable. It will be too late to develop the defenses of counter-equities, after a hearing has been had on the question of subordination.

Furthermore, the decision of the Circuit Court has an important bearing upon the law of evidence in corporate reorganization proceedings. The Circuit Court excludes certain evidence from the type of evidence which the reorganization trustee is obliged to investigate. The evidence thus excluded from the investigation relates to, (a) the *time of purchase* of securities by those who would benefit from the subordination of the parent, together with the related question of whether such securityholder bought into the reorganization proceedings with *notice* of the acts complained of, and (b) the *cost* to the security-holder of the securities which he purchased, together with the related question of the *profit* which he will derive if he is granted the privilege of subordination. The corporate defendant in a "Deep Rock" case is thus denied any practical means of showing, what may well be the fact, that the majority of the debtor's securities are in the hands of speculators who recently bought them with full knowledge of the facts, and for the purpose of stirring up litigation. He is denied the means of showing that these securities were purchased for a trivial price, a price so low that the effect of allowing the subordination of the parent would be to skyrocket the speculator's profit to approxi-

mately 1200% on their investment. Even more shocking facts than these may be disclosed by investigation.

The question whether a corporation, against whom a "Deep Rock" claim is asserted, is entitled to know the identity of its adversaries, or the time when they acquired their securities, has never been passed upon by this Court. Because of the importance of the questions involved, we submit that these questions should be authoritatively answered.

The question whether the cost of securities to their present holders is relevant to the application of the "Deep Rock" rule, has never been passed upon specifically by this Court in a "Deep Rock" case. As we shall point out, however, (infra, p. 13) the decisions of this Court in other cases demonstrate that this aspect of the question should be answered contrary to the decision of the Court below.

2. The Decision of the Circuit Court is in Conflict with Decisions in other Circuits insofar as it Excludes from the Scope of the Trustee's Investigation Evidence of a Type which has been Treated as Relevant in Other Circuits.

The Circuit Court declines to have the Trustee investigate whether securities, on whose behalf a "Deep Rock" claim is asserted, have been purchased at a recent date and with knowledge of the acts of which complaint is made. In other circuits, however, courts have made reference to these very same circumstances in disposing of "Deep Rock" claims.

In *Godfrey v. Powell,* 150 F. 2d 486 (5 Cir., 1945) in disposing of the contention of certain appellants that bonds of other parties should be subordinated, the Fifth Circuit took into consideration the fact that appellants had bought into the proceeding at a recent date. It said (150 F. 2d 489-490):

> "We put to one side the *untenable position of the active appellants in having bought into a situation for the purpose of attacking transactions which had taken place before their purchase,* to consider the matter from the standpoint alone of the other bond holders." (italics supplied).

Similar evidence was taken into consideration in the corporate reorganization proceedings of *Missouri Pacific R. Co.* (64 F. Supp. 64; E.D. Mo., 1945). The Court there dealt, among other things, with the contention of one Comstock that certain claims should be subordinated to his own. In dismissing his contention, it took into consideration the time when Comstock became a securityholder (64 F. Supp. at 77-78).

> "*The objector Comstock purchased the securities which give him entree to this proceeding as a speculation in the latter part of 1942 and in the early part of 1943,* and he did not become a party until September 30, 1943. No facts have been shown that have not been available to all for many years; and Comstock's being a newcomer does not relieve him from the defense of laches. The bonds that he holds are subject to all of the infirmities which existed at the time he bought them. * * * Comstock cannot contend he is in the position of a person from whom the facts have been concealed. Rather, he has taken facts apparent to all and only at the twelfth hour has come forward." (italics supplied)

3. The Circuit Court's Decision is in Conflict with the Decisions of this Court, in that it Excludes from the Scope of the Trustee's Investigation Evidence which, under the Decisions of this Court, is Relevant.

The Circuit Court holds that a reorganization trustee, in making an investigation as to the application of the "Deep Rock" rule, may ignore the question of the cost of acquisition by public security-holders, and the extent of the profit which would inure to such security-holders if the remedy of subordination were granted. There are decisions in this Court, on the other hand, which clearly hold that a court of equity, in determining whether equitable relief should be granted, will give consideration to the extent of the profit which would inure to the plaintiff by virtue of the relief for which he prays. *Jencks v. Quidnick Co.*, 135 U. S. 457, 10 S. Ct. 655 (1890). *Mississippi & Missouri Railroad Co. v. Cromwell*, 91 U. S. 643, 23 L. Ed. 367, 368 (1876).

CONCLUSION.

For the foregoing reasons it is respectfully submitted that writs of certiorari should issue to the Circuit Court of Appeals for the Third Circuit.

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THOMAS J. MUNSCH, JR.

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BRIEF IN SUPPORT OF PETITION.

OPINIONS BELOW.

The opinion of the District Court (McVicar, J.) on the Motion filed November 21, 1945 (No. 9125 in the Circuit Court of Appeals) is reported at 64 F. Supp. 231, and appears at pages 27 a to 29 a of the Record.

The opinion of the District Court (McVicar, J.) on the Petition filed March 6, 1946 (No. 9163 in the Circuit Court of Appeals) is not yet reported, but appears at pages 77 a to 81 a of the Record.

The opinion of the Circuit Court of Appeals for the Third Circuit (McLaughlin, J.) is not yet reported, but appears at pages 85 to 90 of the Record.

JURISDICTION.

See Petition for Writs of Certiorari, page 8, *supra*.

STATEMENT OF THE CASE.

See Petition for Writs of Certiorari, page 2, *supra*.

SPECIFICATION OF ERROR.

The Circuit Court of Appeals erred in excluding from the proper scope of the reorganization trustee's investigation into possible grounds for the equitable limitation or subordination of claims of the parent of the debtor, (a) the identity of the persons who would profit by such limitation or subordination, and (b) whether there are counter-equities against such persons.

ARGUMENT.

Summary.

Where an investigation is ordered to determine whether the claims of a parent should be subordinated, it should develop *all* of the facts which have a bearing on that question. Facts relevant to the defenses of the parent should be developed along with those which may be relied upon as a basis for the parent's subordination.

First and most important, the identity of the persons who would profit by the subordination of the parent should be ascertained. (*infra,* p. 17).

Furthermore, investigation should be made into possible counter-equities against those who would profit by subordination. The following questions, among possible others, should be answered:

When did such persons acquire their securities? (*infra,* p. 20).

Have they purchased with notice of the acts of which they complain? Have they purchased since the inception of the reorganization? (*infra,* p. 21).

What was the cost to them of their securities? (*infra*, p. 26).

How much profit will inure to them if the remedy of subordination is granted? Will their profit be unreasonably high? (*infra*, p. 26).

Any investigation which ignores these questions is necessarily incomplete, one-sided, and unfair in its result.

1. The Identity of Persons Who Would Profit by Subordination Should Be Investigated.

The claims of a parent company cannot be subordinated in the abstract. If subordinated at all, they must be subordinated to the obligations of someone else. And when the court, in the exercise of its equitable powers, comes to consider the question whether the claims of a parent company should be subordinated, it must necessarily determine to whom they will be subordinated. In other words, it must determine who will be parties to benefit by its action.

In the present case, however, the ownership of a majority of the publicly-held bonds of the Debtor is unknown (R. 33 a, 34 a). This lack of knowledge of the identity of parties arises from the fact that certain public securityholders may participate in distribution by virtue of claims filed by their indenture trustees. They may do this by virtue of the Order of the reorganization court dated July 22, 1938, Section 14(a) of which provides in part:

"Holders of bonds and other securities issued under indentures shall not be required to file separate proofs of claim in order to preserve their rights on

distribution as aforesaid, but the proofs of claim filed by the respective indenture trustees shall be deemed filed on behalf of the respective holders thereof insofar as preserving their rights on distribution are concerned."

A similar privilege is granted by Section 198 of Chapter X, 11 U.S.C.A. 598, which provides:

"An indenture trustee may file claims for all holders, known or unknown, of securities issued pursuant to the instrument under which he is trustee, who have not filed claims: Provided, however, that in computing the majority necessary for the acceptance of the plan only the claims filed by the holders thereof, and allowed, shall be included."

It is important to analyze the nature of the rights granted to the indenture trustees by the foregoing provisions. The right granted is merely the right to file a claim. It is a right merely to assert the contractual rights of the bondholder to *equality* of treatment with other bondholders. It is not the right to secure the privilege of preferred treatment for a bondholder by virtue of a claim for mismanagement based on a tort committed by another bondholder. When, therefore, it is asserted that the claim of the indenture trustee goes beyond asserting the right to equality of treatment, a court of equity, before it lends its aid, should require the beneficiaries of the claim to come out into the open and reveal their identity.

It is not inequitable to require this information from persons to whom a court of equity is asked to give a preferred standing. Equitable though it may be to permit them to remain anonymous while receiving equality

of treatment in distribution (and section 198 does no more than this), it is not equitable to permit a preferred standing to be attributed to them while their identity remains undisclosed. A court of equity should refuse to exercise its extraordinary powers on behalf of one who refuses to come out into the open and be identified. Equity acts in personam.

Furthermore, section 197 of Chapter X (11 U.S.C.A. 567) calls for an investigation into the "liabilities" of the debtor. This should refer not merely to some, but to *all,* liabilities, whether owed to a parent corporation or to others.

2. Counter-Equities Against the Persons Who Would Profit by Subordination Should Be Investigated.

An investigation should be undertaken if the facts to be investigated have some probative value and are proper items for consideration by the court. It is not necessary that the facts sought to be ascertained be of themselves sufficient to bar the asserted preferred standing of public security holders. Evidence, to be admissible, need not be completely determinative of the issue. It need merely carry some weight.

Conversely, investigation should be denied only if the matters to be investigated could not possibly be relevant under any conceivable fact situation that investigation might disclose.

In urging, therefore, that the counter-equities of cost, notice, and time of acquisition be investigated, we do not deem it our burden to prove that this fact or that one, or even the whole group of facts which we shall discuss, would, if true, deny a preferred status to those for whom a preference is claimed. It is enough to prove

that these facts would have some effect upon the conscience of the chancellor and therefore should be laid before him.

We turn, then, to the type of counter-equity which should be investigated, but which the court below has refused to investigate. In analyzing these factors, we make no claim that our list of them is all-inclusive. We contend merely that these are some of the facts which must be taken into account if an investigation of the "Deep Rock" question is to be complete:

(a) The time of acquisition of claims (*infra*, p. 20).

(b) Notice, laches, and estoppel (*infra*, p. 21).

(c) The cost of acquisition of claims (*infra*, p. 26).

(a) *Time of Acquisition of Claims*

Numerous sections of Chapter X. make relevant the question of the time when securities were acquired. Section 166, 11 U.S.C.A. 566, provides that the court may refuse to permit inspection of schedules of creditors, etc., "by any creditor or stockholder who acquired his claim or stock within three months preceding the filing of the petition under this chapter or during the pendency of the proceeding."

Section 203, 11 U.S.C.A. 603, provides that the refusal to accept a plan may be disregarded where it is not in good faith "in the light of or irrespective of the time of acquisition" of such claim.

Sections 210 and 211, 11 U.S.C.A. 610, 611, provide that said information as to the time of the acquisition of claims be filed by certain attorneys and committees. Section 212, 11 U.S.C.A. 612, provides for the limitation to the actual consideration paid therefor as to "any

claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter." Obviously, the application of this section requires a determination of the time of acquisition of the security in question.

In "The Conflict of Equities Under the 'Deep Rock' Doctrine", 43 Columbia Law Review, 336, 352, the author, Robert A. Sprecher, states:

> "All claims or interests purchased subsequent to the commencement of bankruptcy proceedings, or prior thereto with knowledge of their imminence, should be subject to special scrutiny by the bankruptcy court, regardless of whether the claims or interests are held by fiduciaries or non-fiduciaries and regardless of whether speculation is actually proved or not."

(b) *Notice, Laches and Estoppel*

Time of purchase is related to the further equitable defenses of notice, laches and estoppel. We submit that one who buys into litigation with his eyes open, does not have the same standing before a court of equity as does one who is imposed upon against his will; and that it will be relevant, therefore, to ascertain whether the parties who would profit by subordination purchased their securities with notice of the acts of mismanagement on which such subordination is sought to be predicated.

In Pomeroy's Equity Jurisprudence (5th Ed., 1941) it is stated (Vol. 2, pp. 601-602) that:

> "When a person is acquiring rights with respect to any subject-matter, the fact whether he is so acting with or without notice of the interests or claims of others in or upon the same subject-matter is

regarded throughout the whole range of equity jurisprudence as a most material circumstance in determining the extent and even the existence of the rights which he actually acquires."

In "The Conflict of Equities under the 'Deep Rock' Doctrine", 43 Columbia Law Review 336, *supra,* the author, in dealing with the situation where grounds exist for the subordination of a parent corporation's claim, concludes (p. 352):

"If it is shown that all claims were purchased after the institution of bankruptcy proceedings, the parent's claim should not be subordinated. If some, but not all, of the claims were purchased after bankruptcy, the parent's claim should be subordinated, but all claims purchased after bankruptcy at a price below that set by the court, or in the absence of such a price, without prior consent of the court, should also be subordinated.

"Observance of these principles by bankruptcy courts would tend to protect innocent claimants and to discourage speculation without appreciably diminishing the bona fide market for negotiable securities. At the same time the parent's claim, and the creditors or stockholders who benefit by allowance of that claim, would be placed in their proper relation to other claimants of the debtor's estate."

There are cases which clearly hold that time of acquisition of securities and notice of acts complained of, are relevant to a determination of a security-holder's rights. Brief reference will be made to these authorities, none of which are distinguished in the Circuit Court's opinion.

In *Godfrey v. Powell,* 150 F. 2d 486 (5 Cir., 1945), the Fifth Circuit, in denying an asserted right to have other claims subordinated, said (pp. 489-490):

> "We put to one side the *untenable position of the active appellants in having bought into a situation for the purpose of attacking transactions which had taken place before their purchase,* to consider the matter from the standpoint alone of the other bond holders." (Italics supplied)

In re Missouri Pacific R. Co., 64 F. Supp. 64 (E.D. Mo., 1945), the court denied the asserted right of one Comstock to have other claims subordinated to his own. It relied upon the fact that Comstock was a recent purchaser, saying (p. 77):

> "The objector Comstock purchased the securities which gave him entree to this proceeding as a speculation in the latter part of 1942 and in the early part of 1943, and he did not become a party until September 30, 1943."

In *Belden v. Burke,* 147 N.Y. 542, 42 N.E. 261 (1895), a holder of railroad bonds filed a bill in equity against certain corporate directors and other parties to compel an accounting for the diversion of the proceeds of the bonds. Because the plaintiff had purchased his bonds with notice that their proceeds had been put to the use of which he later complained, the bill was dismissed. The Court said (147 N.Y. 556):

> "Having acquired the bonds with knowledge of all the facts, he must, in equity, be deemed to have acted upon and acquiesced in the condition of the security as he found it."

Also in point, to the same effect, are *American Brake Shoe & Foundry Co. v. Interborough R. Transit Co.*, 112 F. 2d 669 (2 Cir., 1940), *Continental Trust Co. v. Toledo, St. L.&K. C.R. Co.*, 82 Fed. 642 (N.D. Ohio, 1897), *Graham v. LaCrosse & M. R. R. Co.*, 102 U.S. 148, 26 L. Ed. 106 (1880), and *De Weese v. Reinhard*, 165 U.S. 386, 17 S. Ct. 340 (1897).

In the case of *re Midland United Co.*, 58 F. Supp. 667, 681, Judge Biggs of the Third Circuit, sitting in the District Court and considering a plan of reorganization, said, with respect to certain objectors to the plan (58 F. Supp. at 681):

> "Many of the objectors are shown to be rather recent purchasers of Utilities debentures and prior lien stock. This of course does not deprive them of the right to be heard in respect to a plan which will dispose of the interests acquired by them and their objections require full consideration. *The fact that the objectors acquired their securities and stock with what must be deemed to be knowledge of existing litigation is, however, a fact which the court may weigh in determining their purpose.*" (Italics supplied)

This case is distinguished by the Circuit Court (R. 90) on the ground that a plan of reorganization was before the Court in the Midland United case. But the Circuit Court overlooks the fact that the purpose of expanding the investigation in the present case is for the sole purpose of making the information to be elicited available to the court when a plan of reorganization ultimately comes before it. If the facts will be relevant when a plan is before the court, they should be investi-

gated now, so that they may be presented to the court in connection with a plan.

Furthermore, the Circuit Court overlooks the analogy of stockholders' suits. If the Pittsburgh Railways were not in bankruptcy, the claims of stockholder-claimants would be asserted in stockholders' suits. The first requirement in a stockholder's suit is that the plaintiff must have owned his shares at the time of the alleged injury of which he complains. This rule has been codified in Rule 23(b) of the Federal Rules of Civil Procedure, which, in turn, stated the rule of *Hawes v. Oakland,* 104 U.S. 450, 26 L. Ed. 827 (1882).

The principle of Rule 23(b) is also the law of Pennsylvania, pursuant to the Act of April 18, 1945, P. L. 253; 12 P.S. 1321. This Act provides that in stockholders' suits:

> "* * * the plaintiff or plaintiffs must aver and it must be made to appear, that the plaintiff or each plaintiff was a stockholder at the time of the transaction of which he complains, or that his stock devolved upon him by operation of law from a person who was a stockholder at such time."

The Circuit Court's decision places a stockholder in a bankruptcy proceeding in a much more favorable position than he would occupy if he were asserting his rights in a stockholder's suit. Such a result, we submit, is contrary to public policy. The rights of the parties should not be permitted to vary according as suit is brought in one court or another or in one form of action or another. *Erie Railroad v. Tompkins,* 304 U.S. 64, 58 S. Ct. 817 (1938).

(c) *Cost of Acquisition*

A court of equity will always take into consideration the question of the profit accruing to one who seeks its aid. If an unconscionable profit will result, aid will be refused. It follows, therefore, that in determining whether the claims of a parent company should be subordinated, the court should take into consideration the actual profit which will inure to those who would benefit by such subordination. This in turn will make it necessary that the court be advised of the cost of the obligations of the Debtor held by the persons who would profit by the subordination of the parent company. Aside from principles of equity, common sense and good business sense should require that this fact be taken into consideration.

As a practical matter, one who has recently acquired a bond of a debtor in reorganization and who asserts a "Deep Rock" claim thereon, is in a dilemma. Either he must show that the price which he paid amounted to a fair compensation to his seller for the asserted equitable cause of action, or he must admit that he is asking a court of equity to give him something for nothing. To pursue this analysis, it may be noted that the bondholder's rights consist of two parts: (1) His legal right to equality of treatment (which he will receive in any event, whether his "Deep Rock" claim is valid or not) and (2) His asserted equitable right to an increment over and above his legal right, as a result of his preferred standing under the "Deep Rock" rule. Even if it be presumed that the purchaser of the bond paid a fair value for his legal right (Item (1), supra), it may be questioned whether the purchase price in-

cluded any allowance for the equitable right (Item (2), supra), which the purchaser asserts. If his price was extremely low, we may presume that no element of the equitable right was taken into account in the purchase. In such a case, therefore, the purchaser of the bond, when he asserts a "Deep Rock" claim, is asking a court of equity to give him something which he never paid for, and which would result in an unjust enrichment to him, as well as an unjust loss to the seller from whom he bought.

We submit that the foregoing is a practical consideration which courts should not ignore, and that it derives support from the decisions of this Court, which make it clear that the profit accruing to one who would benefit by a decree in equity will be taken into consideration by the court whose aid he seeks.

In *Jencks v. Quidnick Co.*, 135 U.S. 457, 10 S. Ct. 655 (1890) this Court affirmed the dismissal of a bill in equity to establish title to certain shares of stock, where it appeared that an unconscionable profit would have resulted to the plaintiff. It said (135 U.S., at 458):

> "In other words, these complainants are asking the interposition of a court of equity to establish their title to property worth over half a million of dollars obtained by purchase at execution sales for $275. The immense disproportion between the value and the cost shocks the conscience of a chancellor, and forbids the supporting action of a court of equity. Some rights must have suffered, and some wrong must have been done, by such a transaction; and a court of equity properly says that it will not lend its aid to further such an unconscionable speculation."

In the case of *Mississippi and Missouri Railroad Co.* v. *Cromwell,* 91 U.S. 643, 23 L. Ed. 367 (1876) a judgment creditor, having levied execution on certain stock of a railroad company, bought it at public auction. When, however, he sought the aid of a court of equity to compel the railroad to transfer the stock, relief was refused for the reason, among others, that the plaintiff would receive an unconscionable profit on the transaction. Referring to the possible profit to the plaintiff, the court said (91 U.S., at 645):

> "To him [the plaintiff] it will be a windfall, like a prize in a lottery. He paid no adequate consideration to entitle him to claim it as a matter of equity. If the law gives it to him, he should seek his remedy at law. Equity will not lend its aid to any such games of hazard. * * * He comes into court with a very bad grace when he asks to use its extraordinary powers to put him in possession of $30,000 worth of stock for which he paid only $50. The court is not bound to shut its eyes to the evident character of the transaction. It will never lend its aid to carry out an unconscionable bargain, but will leave the party to his remedy at law."

In numerous reorganizations, Courts have taken into account the consideration paid for claims by creditors. *J. S. Farlee Co. v. Springfield South Main Realty Co.,* 86 F. 2d, 931, 936 (1 Cir., 1936). *Palmer v. Bankers' Trust Co.,* 12 F. 2d 747, 754 (8 Cir., 1926). *Guaranty Trust Co. of New York v. Chicago M. & St. P. R. Co.,* 15 F. 2d 434, 443 (N.D. Ill., 1926).

In re McEwen's Laundry, 90 F. 2d 872, 873 (6 Cir., 1937) the Court refused to dismiss a petition that sought, as to claims assigned after the inception of a

reorganization, "that the Court order an accounting be had and determine the consideration paid therefor."

The McEwen case has been cited with approval by this Court which said, in *American United Mut. Life Ins. Co. v. City of Avon Park,* 311 U.S. 138, 146; 61 S. Ct. 157, 162:

> "The requirement of full, unequivocal disclosure; the limitation of the vote to the amount paid for the securities (In re McEwen's Laundry, Inc., 6 Cir., 90 F. 2d 872); * * * indicate the range and type of the power which a court of bankruptcy may exercise in these proceedings."

That the cost of acquisition is a proper item for consideration by the court is further indicated by General Order 21(3) in Bankruptcy, which provides:

> "If a claim has been assigned after the commencement of the proceedings, but before proof of claim has been filed, the proof of claim therefor shall be supported by an affidavit of the owner at the time of the commencement of the proceedings, *setting forth the true consideration for the debt,* what payments have been made thereon, and that it is entirely unsecured, or if secured, the security as is required in proving secured claims." (italics supplied).

Another fault of the Circuit Court's decision is that it loses sight of the distinction, pointed out above (pp. 26-27), between a securityholder's claim in contract on his bond, and his claim in tort for mismanagement. The Third Circuit in this respect fails to draw a distinction which has been observed in the Second Circuit where, under the law of New York, the transfer of a bond does not operate to pass a cause of action for tort unless such

cause of action is specifically assigned. *Elias v. Clarke,* 143 F. 2d 640, 644 (2d Cir. 1944; cert. den. 323 U.S. 778, 65 S.Ct. 191. *Re Associated Gas & Electric Co.,* 149 F. 2d 996, 1008 (2d Cir., 1945; cert. den. 326 U.S. 736, 66 S. Ct. 45).

Since New York is the residence of the persons most actively urging subordination, many of the bonds in the instant case were undoubtedly transferred to their present holders in that State. Since, in such a case, a cause of action for mismanagement would not pass unless it were specifically assigned (Restatement, Conflict of Laws, sects. 349, 350), investigation would probably disclose that the present holders of the bonds are not entitled to assert claims for mismanagement. The same may be true of assignments made in Pennsylvania or in other states. The effect of the instant decision, however, is to foreclose any inquiry into this highly important question.

3. The Authorities Relied Upon by the Circuit Court Are Not in Point.

The Circuit Court rests its decision on *Lorraine Castle Apartments Bldg. Corporation,* 149 F. 2d 55, 7th Cir., 1945, and *Standard Gas & Electric Company v. Deep Rock Oil Corp.,* 117 F. 2d 615, 10th Cir., 1941. Neither of these cases is controlling on the point at issue.

The *Lorraine Castle* case goes no further than to say that a security holder will not ordinarily be limited in his participation to the cost which he paid for his security. The case holds that where a security holder merely seeks *equality* of treatment, the price which he paid for his security is irrelevant. But such a decision is quite different from the instant case in which public

security holders are seeking *priority* in distribution by virtue of the Deep Rock Rule. We submit that, where priority is sought by public security holders (as in the instant case) the counter-equities above referred to are relevant, and the *Lorraine Castle* case decides nothing to the contrary.

The *Standard Gas & Electric* case involved an attempt by Standard Gas to ascertain the cost to public security holders of their securities. The question of identity of security holders or the time of acquisition does not appear to have been in issue. Furthermore, the question of cost was not raised until *after* the question of subordination had been decided by this court. (*Taylor v. Standard Gas and Electric Co.,* 306 U.S. 307, 59 S. Ct. 543, 1939), and after the Circuit Court, on remand of the case, had construed this court's mandate as unqualifiedly commanding the subordination of Standard's claims. (*In re Deep Rock Oil Corporation,* 113 F. 2d 266; 1940). The Court's subsequent decision to deny an inquiry into the cost of claims (117 F. 2d 615; 1941) was therefore based on nothing more than the Court's obligation to abide by what had previously been decided by this Court and to refuse a reopening, for further evidence, of a matter which was *res adjudicata.* Such a decision is not authority in opposition to a prompt and timely request for an investigation such as was made in the instant case.

Respectfully submitted,

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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM 1946

In the Matter of
PITTSBURGH RAILWAYS COMPANY,
Debtor.

No. 1178

PHILADELPHIA COMPANY,
Petitioner,
v.
JULES GUGGENHEIM, et al.

No. 1179

PHILADELPHIA COMPANY,
Petitioner,
v.
JULES GUGGENHEIM, et al.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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TABLE OF CONTENTS

	PAGE
Counter Statement of Question Involved	1
Statement	2
Opinions Below	3
The Facts	3
Proceedings Leading to Investigation of Philadelphia	3
Efforts of Philadelphia to Broaden the Investigation	4
Observations on Philadelphia's Statement of the Case	6
The Argument:	
I—The law is well settled that:	
Neither the cost of his security, nor the time of its acquisition, nor his knowledge of the undenied facts alleged in our petition, precludes a public security holder from benefiting through the absolute bar or the complete subordination of the claims of Philadelphia—which operated and controlled Pittsburgh Railways system—to the claims of all public security holders.	
No public security holder to whom the sanctions of Section 212 of the Bankruptcy Act are inapplicable, profits by recovery of the entire amount of his security according to its terms	7
II—There is no warrant in the Bankruptcy Act for an examination under Section 21 (a) or an investigation under Section 167 of all public holders of notes, bonds, securities or liabilities of the debtor to ascertain when and at what prices these public holders acquired their securities	22

PAGE

III—That there is no conflict of decisions on the point in issue is clear from Point I 27

IV—The questions presented by Philadelphia are not of sufficient importance to require review by this court 27

Conclusion 27

TABLE OF CASES

American Brake Shoe v. Interborough Rapid Transit, 2 Cir., 112 Fed. (2) 669 17

Belden v. Burke, 147 N. Y. 542, 148 N. Y. 760 17

Celotex Co., In re, 12 F. Supp. 1 8

Chanson, In re, 20 Fed. Supp. 244 23

Cohen v. Cities Service, 2 Cir., 45 Fed. (2) 687 21

Continental Trust Co. v. Toledo, 82 Fed. 642 18

Davidson v. Bankers B. & M., 35 Fed. Supp. 825 21

Deep Rock Oil 8, 21, 27

DeWeese v. Reinhard, 165 U. S. 386 20

Foerst, In re, 93 Fed. 190 25

Fox Metropolitan Playhouse, In re, 2 Cir., 74 Fed. (2) 722 ..... 22, 25

Galdi v. Jones, 2 Cir., 141 Fed. (2) 984 21

Godfrey v. Powell, 5 Cir., 150 Fed. (2) 486 15

Goldstein v. Groesbeck, 2 Cir., 142 Fed. (2) 422 21

Graham v. Railroad, 102 U. S. 148 19

Guaranty Trust Co. v. Chicago M. & St. Paul, 15 Fed. (2) 434 16

PAGE

Guaranty Trust Co. of N. Y. v. Seaboard Air Lines, 62 Fed. Supp. 22 13

Horgan, In re, 2 Cir., 98 Fed. 414 23

Indiana Central Telephone Co., In re, 24 F. Supp. 342 8

Jencks v. Quidnick, 135 U. S. 457 11

Lorraine Castle Apts. Bldg. Corp., In re, 7 Cir., 149 Fed. (2) 55 ..... 7, 9

Madero Bros, In re, 256 Fed. 859 ..... 22, 24

Mississippi & Missouri v. Cromwell, 91 U. S. 643 11

Missouri Pacific R. Co., In re, 64 Fed. Supp. 64 16

Mokava Corporation v. Dolan, 2 Cir., 147 Fed. (2) 340 7, 9

Palmer v. Bankers Trust Co., 12 Fed. (2) 747 20

Phelan v. Middle States Oil Corp., 2 Cir., 154 Fed. (2) 978 14

Pittsburgh Railways, In re, 3 Cir., 159 Fed. (2) 630, Record 85 ..... 3, 6, 8

Pittsburgh Railways, In re, 3 Cir., 155 Fed. (2) 470 ..... 2, 6

Pittsburgh Railways, In re, 64 Fed. Supp. 232 ..... 2, 3, 6, 22

Pittsburgh Railways, In re, 23 Pa. U. C. 65 4

Pittsburgh Railways, In re, 63 Fed. Supp. 7 ..... 2, 3

Pittsburgh Railways, In re, Record 77a to 81a 3, 22

Prudence Co., Inc., In re, 2 Cir., 88 Fed. (2) 628 ..... 22, 24

Point Building Land Co., In re, 37 A. B. R. (N. S.) 464 8

Security-First Nat'l Bank v. Rindge, 9 Cir., 85 Fed. (2) 557; 86 Fed. (2) 3 ..... 8, 9, 10, 22, 24, 25, 26

PAGE

Standard Gas v. Deep Rock Oil, 10 Cir., 117 Fed. (2) 615 ..... 8, 27

Steinman, In re, 3 Cir., 155 Fed. (2) 755 23

Youroveta Home & Foreign Trade Co., Inc., In re, 2 Cir., 288 Fed. 507 22

Utilities Power & Light Corp., In re, 29 F. Supp. 763 ..... 8, 10

STATUTES

Bankruptcy Act:

Section 21(a) 1, 2, 3, 5, 22, 23, 25, 26
Section 41(a) 25
Section 167 ..... 1, 2, 3, 5, 22, 23
Section 212 ..... 1, 7, 11, 12, 14

Federal Rules of Civil Procedure:

Rule 15 5
Rule 23(b) 21

OTHER AUTHORITIES

Black on Bankruptcy, Sec. 269 23

2 Collier on Bankruptcy, 14 ed., p. 281, Sec. 21.11 ..... 23, 24

The Conflict of Equities Under the "Deep Rock" Doctrine, 43 Col. Law Review 336 ..... 12, 13

Counter Statement of Question Involved

In this reorganization under Chapter X of the Bankruptcy Act, where, upon a sworn petition filed by public security holders,—containing undenied allegations charging Philadelphia, as parent of the debtor, with, (1) spoliation and waste of debtor, (2) domination and control of debtor and the resulting detriment to us and all public security holders, (3) possible causes of action or claims available to the estate against Philadelphia, (4) grounds for an equitable limitation or subordination of filed claims, and (5) forfeiture of Philadelphia's rights to assert a claim on a parity with other claims, the District Court directed the Trustee to examine and investigate Philadelphia pursuant to Sections 21 (a) and 167 of the Bankruptcy Act, shall that order for such examination and investigation be extended in scope so as to include an examination and investigation of every public holder of bonds, notes, securities and liabilities to ascertain when and at what price each public security holder acquired his security, in order to bar or limit his claim or to prevent subordination of the claims of Philadelphia, the parent of the debtor, despite the absence of any showing that public holders are subject to Section 212 in Chapter X of the Bankruptcy Act or that the public security holder was a fiduciary of the debtor or constituted any part of the debtor's management?

Statement

After unsuccessfully attempting to escape its (Philadelphia's) examination and investigation pursuant to Sections 21 (a) and 167 of the Bankruptcy Act, directed on our petition, by an order of November 7, 1945 (63 F. Supp. 7 at p. 10), which denied Philadelphia's request that if an investigation be ordered as to it, "a similar investigation should be made with respect to the claims of all creditors", from which no appeal was taken, Philadelphia here seeks a review of denial of its subsequent renewed applications to extend that investigation to us and to "all holders of bonds, notes, securities or liabilities", thousands in number scattered over the United States, and to "all notes, bonds, securities and liabilities" (63 F. Supp. 7; 64 F. Supp. 231; Record pp. 77a-81a). Philadelphia, which operated and managed Pittsburgh Railways System, is the sole stockholder of debtor and most of its underliers constituting that unified Pittsburgh Railways System of transportation (155 Fed. (2) 477, cert. denied). Philadelphia is also the largest creditor according to filed claims. Philadelphia has not been exonerated from the undenied allegations of misconduct charged in our petition.

The Circuit Court of Appeals for the Third Circuit unanimously affirmed two orders made January 21, 1946 and May 1, 1946, in the proceedings for the reorganization of the debtor, by the District Court for the Western District of Pennsylvania, denying Philadelphia's applications to extend the investigation to all creditors.

Opinions Below

The District Court's opinion and order of November 7, 1945 for the examination of Philadelphia under Sections 21 (a) and 167 of the Bankruptcy Act are reported at 63 F. Supp. 7. At that time the District Court rejected the request of Philadelphia that if an investigation be ordered as to it, "a similar investigation should be made with respect to the claims of all creditors". No appeal was taken from order.

The District Court's opinion denying, without prejudice, Philadelphia's November 21, 1945 renewed application to examine all creditors (No. 9125 in the Circuit Court) is reported at 64 F. Supp. 231.

The District Court's opinion denying, with prejudice, Philadelphia's March 6, 1946 further renewed application to examine all creditors (No. 9163 in the Circuit Court) is not yet reported, but appears in the record at pages 77a to 81a.

The unanimous opinion of the Circuit Court affirming Nos. 9125 and 9163 is reported at 159 Fed. (2) 630 and appears in the record at pages 85 to 90.

The Facts

Proceedings Leading to Investigation of Philadelphia

April 23, 1918, the present Trustees, George and C. A. Fagan, were appointed Equity Receivers by the District Court below. These receivers were discharged in February, 1923. Philadelphia participated in bringing this about. Philadelphia postponed "its claims against Pittsburgh Railways Company and underlying street railway companies" (ff. 453-463, 470*).

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* "F" refers to Finding of Fact bearing that numeral in the Report of the Special Master in 155 Fed. (2) 477, cert. denied October 14, 1946, 67 S. Ct. 89.

The Facts.

May 10, 1938, debtor filed a voluntary petition for reorganization under Section 77B of the Bankruptcy Act (f. 1). November 7, 1938, Chapter X made applicable. Three Trustees were appointed (f. 3), one of whom died. The surviving Trustees are George, the former equity receiver, and Thomas Fitzgerald, former general manager of debtor and a former director of Philadelphia (ff. 3, 221, 382).

The Trustees' Amended Revised Plan of Reorganization for Debtor, on which no hearings have been held, recognizes Philadelphia claims on a parity with publicly held claims.

The Pennsylvania Public Utility Commission, performing its statutory function of approving the new capitalization under the Trustees' Amended Revised Reorganization Plan, said that it is for the federal court to determine the extent to which Philadelphia should participate in the benefits of that plan (23 Pa. P. U. C. 65, 69).

Efforts of Philadelphia to Broaden the Investigation

On December 22, 1944, we, Jules Guggenheim et al., public security holders of Pittsburgh Railways System, filed a sworn petition, in the District Court, setting out spoliation and waste of the debtor by Philadelphia to the detriment of the public security holders, possible causes of action to the debtor's estate and grounds for the equitable limitation or subordination of Philadelphia's filed claim to the claims of public security holders. That petition prayed *inter alia* that the claims of Philadelphia be barred or subordinated. In the consideration of that petition the District Court directed the Special Master at the earliest moment to file his report on the petition of the City of Pittsburgh filed October 23, 1942. Pursuant to

The Facts.

Rule 15, FRCP the prayers for relief in our petition were subsequently amended to a request, among other matters, for an investigation under Sections 21 (a) and 167 of the Bankruptcy Act into possible claims or causes of action available to the debtor against Philadelphia and any other party and into grounds for the subordination or equitable limitation of claims filed by Philadelphia. At the hearing on the amended petition the Securities and Exchange Commission, the City of Pittsburgh and others supported this prayer. Philadelphia did not file or serve any answer denying the allegations of our petition. Philadelphia, purporting to appear specially, moved to dismiss the petition, its contentions including the request that if an investigation be ordered as to it, "a similar investigation should be made with respect to the claims of all creditors". On November 7, 1945 the District Court refused Philadelphia's motion to dismiss, did not adopt its suggestion of an investigation of all creditors' claims, and directed the Trustee to conduct the investigation sought. No appeal has been taken from this ruling.

Philadelphia, again purporting to appear specially, on November 21, 1945, filed a motion to amend the November 7, 1945 order, seeking again to have the inquiry relate not only to Philadelphia but to all holders of the securities and liabilities of the debtor, including public holders, whether or not they filed claims on their holdings. Philadelphia urged that members of the public had bought large amounts of the debtor's securities during the reorganization at low prices; that these purchases were made when the question of Philadelphia's subordination by reason of its previous conduct respecting the debtor had been raised; that the market prices of the securities had gone up substantially since the inception of the proceedings; that any further enhancement by reason of Philadelphia's subordi-

nation might result in the "unjust enrichment" of such purchasers; that these facts, if established, warranted the court in denying public holders the benefits, in whole or in part, of any subordination or limitation of Philadelphia's claims, or in subordinating the claims of these security holders; and that the court should therefore order an inquiry into the identity of the public holders and the time and cost of their purchases. On January 21, 1946, the District Court denied Philadelphia's application with leave to renew "upon a presentation of proper facts in support thereof" (Circuit Court Appeal No. 9125).

On March 6, 1946, Philadelphia, once more purporting to appear specially, filed a petition, which, after reciting the identical substantive facts and conclusions that it had previously presented to the court in support of its rejected motion, prayed for the identical relief. Various parties objected, on practical grounds, on jurisdictional grounds, and on the ground that the facts alleged did not warrant the requested relief. On April 25, 1946, the court, after hearing these objections, determined that it would not receive evidence offered by Philadelphia in support of the allegations of its petitions, and on May 1, 1946, it dismissed the Philadelphia petition without prejudice (Circuit Court Appeal No. 9163).

Observations on Philadelphia's Statement of the Case

At page 3 Philadelphia stresses similarity of some of the allegations in our petition and the city's petition. Both challenge the separate corporate form. The Special Master's report, dismissed the city's petition and upheld the separate corporate form. The Circuit Court reversed and pierced the corporate veil, stating: "the facts * * * call for the treatment of this great transportation system as one entity for reorganization purposes" (155 Fed. (2) 477 at 485).

The Argument.

At page 7 Philadelphia concedes it lacks evidence of any fraud or counterequities against public security holders. Nevertheless, Philadelphia speaks of fraud of public security holders and of counterequities against them in Philadelphia's favor, and does not allege any facts upon which such contentions might conceivably be predicated. These claims are used to color Philadelphia's argument.

Furthermore, Philadelphia is silent on its domination, control and operation of Pittsburg Railways System, alleged in our petition, which, under well-established law, infects Philadelphia, as operating parent, with the claims of the public security holders.

THE ARGUMENT

I

The law is well settled that:

Neither the cost of his security, nor the time of its acquisition, nor his knowledge of the undenied facts alleged in our petition, precludes a public security holder from benefiting through the absolute bar or the complete subordination of the claims of Philadelphia—which operated and controlled Pittsburgh Railway System—to the claims of all public security holders.

No public security holder to whom the sanctions of Section 212 of the Bankruptcy Act are inapplicable, profit by recovery of the entire amount of his security according to its terms.

In re Lorraine Castle Apartments Bldg. Co. (C. C. A. 7), 149 Fed. (2) 55, cert. denied 326 U. S. 728.

Mokava Corporation v. *Dolan* (C. C. A. 2), 147 Fed. (2) 340.

Standard Gas & Electric v. *Deep Rock Oil* (C. C. A. 10), 117 Fed. (2) 615 at 619.

Security-First Nat. Bank v. *Rindge Land and Nav. Co.* (C. C. A. 9), 85 Fed. (2) 557, cert. denied 299 U. S. 613, 86 Fed. (2) 3.

In re Utilities Power & Light Corp. (N. D. Ill.), 29 F. Supp. 763, 770.

In re Indiana Central Telephone Co. (D. Del.), 24 F. Supp. 342, 344.

In re Point Building Land Co. (W. D. Pa.), 37 A. B. R. (N. S.) 464, 466.

In re Celotex Co. (D. Del.), 12 F. Supp. 1, 5.

Philadelphia's authorities were carefully considered below. They are not to the contrary (pp. 11, 12, 15-21, infra).

10 Cir. Dealing with the subordination of a parent's claim, *Standard Gas & Electric* v. *Deep Rock Oil,* 117 Fed. (2) 615, cert. denied 313 U. S. 564, 61 S. Ct. 842, held at page 619 that "the prices which security holders pay for their securities does not affect the measure of their participation under the plan of reorganization."

3 Cir. The Circuit Court at bar said (159 Fed. (2) 630, 633; Rec. p. 90):

> "Appellant (Philadelphia) suggests that it is inequitable to allow them (the public security holders) preferred standing. * * * The preferred status complained of * * * springs directly from the alleged unconscionable conduct of Philadelphia Company (which if established would subordinate or limit the latter's claims) and from the further fact that the appellant's charges contain nothing to prevent the unknown public bondholders from taking advantage of the situation brought about by Philadelphia Company's own acts."

The Argument.

7 CIR. *In re Lorraine Castle Apts. Bldg. Corp.*, 7 Cir., 149 Fed. (2) 55, denied a petition to limit to cost speculating public security holders' claims acquired during the course of the reorganization. That reorganization, like the one at bar, involved a solvent parent, which had guaranteed the obligation of the debtor subsidiary. That court stated (p. 57) that the master "pointed out specifically that the persons who had dealt in the bonds were not officials, directors or stockholders of the corporation; that they owed no fiduciary duty to the estate or its beneficiaries; that they were strangers to the proceedings, investors or speculators in securities who thought the bonds were selling too cheaply and that they might make a legitimate profit upon them. He found that there was no fraud."

2 CIR. *Mokava Corp.* v. *Dolan*, 147 Fed. (2d) 340, 344, 345, from which the court below quoted as follows, held:

> "To reduce a creditor's participation in the plan to the amount he paid for his bonds (except in unusual circumstances not present here) would be harmfully to reduce the value of such bonds to those who previously owned them."

9 CIR. *Security-First National Bank* v. *Rindge*, 85 Fed. (2) 557, cert. denied 299 U. S. 613, involving a debtor in reorganization proceedings under Section 77B. A competition developed between two groups to acquire the bonds held by committee, organized prior to the bankruptcy petition. One group finally acquired 98% of the outstanding bonds at 40 cents on the dollar plus expenses incurred by the committee. The plan of reorganization provided for payment of 40 cents on the dollar on the 98% of the bonds acquired by the purchasing group and

for payment of the remaining 2% of the bonds at the face value. The Circuit Court rejected the contention that payment should be limited to the "consideration paid • • • in acquiring the bonds" and directed full payment to the purchasing group, saying (561):

> "The legal value or property right in an obligation is the right to recover from the maker to the entire extent of his promise to pay. The consideration given for a security by the holder thereof is immaterial."

9 Cir. On rehearing that court said (86 Fed. (2) 3):

> "In the absence of any lawful obligation to the debtor, the purchase of the bonds is not converted into a fraudulent conspiracy because one or all the negotiators had a motive, however unethical in character, which would be satisfied by the fact that the lawful profit, if made, would exhaust the proceeds of the sale of the security given by the debtor corporation and leave nothing for it and its stockholders."

Thus we find accord in the 2nd, 3rd, 7th, 9th and 10th Circuits, without this court or any Circuit Court to the contrary.

As the court below so well said (Record p. 89):

> "Under the sound authority of the above cases the alleged discount purchases of Pittsburgh Railways' securities during reorganization and with notice of the wrongdoing of Philadelphia Company are not thereby either subject to subordination themselves or to counter equities barring them from profiting by the subordination of Philadelphia Company. The opinions cited by appellant are not persuasive to any contrary view."

The fact that the holder of the debentures may have purchased them at less than par does not affect his right to priority (*In re Utilities Power & Light*, supra).

The Argument.

Neither *Mississippi* v. *Cromwell* (pp. 13, 38) nor *Jencks* v. *Quidnick* (pp. 13, 27) nor the aborted excerpts therefrom support Philadelphia.

The *Jencks* case arose out of a transfer challenged as fraudulent. This court said (p. 460): "If the transfers * * * by Spragues for the benefit of their creditors are sustained, the purchaser gets nothing." The purchaser was a champetrer. Philadelphia created and maintained a public trading market for the securities of Pittsburgh Railways. If the purchaser of a publicly traded security is to be considered champetrer, then all trading of public securities must cease.

In the *Mississippi* case the plaintiff was proceeding under an execution sale against Muscatine County, Iowa. He was seeking to have transferred to him railroad stock that had been in the name of Muscatine County, and had been deposited by it under an agreement for the sale of the railroad under foreclosure. This court said (p. 644):

> "Now, as the stock * * * by the foreclosure and sale * * * had become completely valueless, if it had not ceased to exist for any purpose except the perception of the sixteen cents * * * the subsequent levy and sale of the stock belonging to Muscatine County was a vain and useless transaction."

This court could have stopped right there in its refusal to direct issuance of such stock. In referring to this case this court, in the *Jencks* case, said (p. 459): "The property and company was gone—its franchises were gone."

Section 212 in Chapter X of the Bankruptcy Act deals with securities acquired in the course of a reorganization. Its purpose is plainly to protect from the possible machinations of those who owe a fiduciary duty. The Bankruptcy

Court's power to limit to cost securities acquired in reorganization is confined to "attorneys, trustees under indentures, securities holders committees" * * * fiduciaries. Philadelphia's petitions and applications do not state any facts making Section 212 applicable to the public holders whose claims Philadelphia would limit to cost.

Thus the test is, do the public holders owe any fiduciary duty? If not, and the public security holders are investors or speculators who thought the securities were selling too cheaply and they might make a legitimate profit on them, the prices which the public holders paid for their securities and the time at which they acquired them in no way affects their participation in the reorganization.

Neither we nor any public holder are fiduciaries or constitute any part of the debtor's management. On the other hand, Philadelphia bore a fiduciary relation to debtor and constituted debtor's management.

"The Conflict of Equities Under the 'Deep Rock' Rule", 43 Columbia Law Review 336, on which Philadelphia relies, says (p. 336):

> "Subordination of a parent corporation's claim against an insolvent subsidiary to the claims of other creditors of the subsidiary is held to be proper in cases where the parent has been guilty of mismanagement of the subsidiary to the detriment of its innocent creditors in a manner so unconscionable as to preclude the parent's seeking the aid in a bankruptcy court. The principle is applied in its simplest form to the situation of the guilty claimant versus innocent creditors of the debtor * * *."

Page 345:

> "Non-Fiduciaries: (1) Mere information. Should the mere fact that the holder of a claim against or interest in a debtor subsidiary has purchased such claim or

> interest subsequent to the institution of bankruptcy proceedings prevent him from receiving the benefits of subordination in the absence of fraud or even speculation? In the interest of equitable bankruptcy administration the answer should be in the affirmative. The courts, however, have held that there is no equity against such a claimant."

Page 347:

> "Not only have the Courts generally held that mere possession of claims or interests acquired subsequent to bankruptcy proceedings is not an equity against the holder, but they have also held that such a holder is entitled to equal treatment with other claimants where it is shown that he possessed confidential information obtained from the trustee in bankruptcy."

If public holders were limited to the amount paid or treated as Philadelphia contends, neither Philadelphia, as parent, nor the debtor would ever offer to the public anything above the current price for the bonds. This would encourage Philadelphia and the debtor to delay the plan of rehabilitation in the hope that it would be able to settle claims against debtor at less than a fair amount. Such results are not in accord with the purposes of the legislation.

There is no general principle of equity that disentitles public holders to buy bonds, and succeed to all rights of the vendors (*Guaranty Trust Co. of N. Y.* v. *Seaboard Air Line,* 62 F. Supp. 207 at 216).

Philadelphia argues (p. 21), "that one who buys—with his eyes open" has no "standing before a court of equity" under such circumstances. Philadelphia's argument means this: A corporation could plunder a subsidiary, and become insulated from liability by subsequently broadcasting its conduct. How absurd.

The Argument.

If the public's purchases were limited, the price paid would become the maximum obtained in distribution. It might well be less. Faced with such an unremunerative prospect, the public would not purchase reorganization securities, although Congress intended an active market of reorganization securities (see Bankruptcy Act, Sec. 212). Those directly injured would be the public investors who acquired their holdings when the enterprise was solvent. With the disappearance of purchasers upon the commencement of the reorganization, or more probably on the first faint rumors of its imminence, they would remain with no alternative but to hold on to an unmarketable security of declining value.

To say that strangers to the debtor—public holders—should recover less because, the parent, or, a fiduciary who wronged the debtor, recovers less, would be a strange perversion of equity.

Complementary to this contention is the "windfall" argument—that the public holders should not recover more because the parent or a wrongdoing fiduciary recovers less. It is at least possible that the discount prices at which many of these holders bought were in part due directly to the low estate into which the debtor had fallen through Philadelphia's conduct and to the fact that no corrective action had been begun. It appears unseemly, at least, to argue that a low purchase price in which Philadelphia's own conduct may have been a factor should be the basis for denying to the public purchasers the benefits of the corrective action. *Phelan* v. *Middle States Oil Corporation*, 154 Fed. (2) 978 (C. C. A. 2), involved charges of wrongdoing by a fiduciary. In that case, the court summarily disposed of the "windfall" argument as follows (at 1001):

> "It is suggested that a purchaser (such as Cohen) should have no right against a receiver because other-

wise the purchaser will acquire a windfall, since he, like the seller, knew nothing of that right when he purchased. But in a great variety of instances, purchasers are permitted to acquire windfalls, e.g., a buyer of land on which oil is discovered after the sale. The Restatement of Contracts, Sec. 171(2) reads: 'Unless otherwise provided in the assignment or by agreement of the assignee with the assignor or with the obligor, an assignee under an effective assignment for value has the same right to any securities for the assigned right that were available to the assignor, though he has not bargained for them, as if the assignor had agreed to transfer them.' If Glass (the receiver) was guilty of wrongdoing, that Cohen's estate will unexpectedly benefit can work no harm to Glass."

Philadelphia's Cases

In *Godfrey* v. *Powell* (pp. 12, 13) the "appeals * * * deal with one of the concluding phases of that (Seaboard Airline Railway) reorganization in that the plan provides for the inclusion of the properties of the All Florida Lines in its reorganized Seaboard system through purchase by the Reorganization Committee at foreclosure sale at not less than a fair upset price" (487). "Of these (decrees on appeal) one upheld the right of the receivers to hold and use and enforce on the same basis as any other holder the $24,543,000 of bonds they had bought on the authority of court orders as a part, and in aid of the reorganization plan" (487, 488). Appellants bought their securities "after the * * * date when the receivers' offer to purchase bonds expires". The court said that the receivers' bonds "were bought with funds of security holders of Seaboard under orders directly authorizing the purchase and with results contemplated and provided for in the orders" (489). After so determining the merits of the controversy in favor of

parity participation by the receivers, that court in the paragraph following made a statement, only a part of which is quoted by Philadelphia at page 12. Omitted is the sentence immediately following, to wit (p. 490):

> "So considering it (the matter from the standpoint alone of other bondholders) we think no reason is presented or appears why any of the purchased bonds (purchased by the Receivers under court order) should be subordinated to the others or other participation in the proceeds of the sale at all limited." (Matter in parentheses inserted.)

Guaranty Trust Co. v. *Chicago, M. & St. P.*, 15 Fed. (2) 434 (p. 28), denied an application for discretionary intervention in a corporate mortgage foreclosure reorganization made after the decree of foreclosure and sale had been entered (437). Five months elapsed between the entry of the decree and the application for intervention (437, 441).

In re Missouri Pacific R. Co., 64 F. Supp. 64, Philadelphia (pp. 12, 23), omits the crux of that court's conclusion, stated thus at page 77:

> "* * * the Court is impressed by the fact that almost all of the transactions of which Comstock complains were entered into only after notice to, and with the approval of, the Interstate Commerce Commission. No substantiation appears for Comstock's innuendo that the Commission was somehow derelict in its duty, or allowed itself to be hoodwinked."

The quotation in Philadelphia's brief when read with the foregoing which precedes it, means that since the challenged transactions were entered into only after notice to and with approval of the Interstate Commerce Commission, "Comstock cannot contend he is in the position of a person

from whom the facts were concealed" (p. 78 of 64 F. Supp.) for the Interstate Commerce Commission records are public. No such situation is presented at bar. At bar, the Pennsylvania Public Utility Commission referred to the federal court, to determine the extent to which Philadelphia should participate in the benefits of the plan. That is presented to the Federal Court by our petition.

That *Belden* v. *Burke,* 147 N. Y. 542 (p. 23), does not aid Philadelphia is emphasized by the change of conclusion of that case reported at 148 N. Y. 760, concerning which change Philadelphia is silent. That litigation involved and rested on the construction of an indenture creating and securing a bond issue not in default. What did the parties intend, and how had they construed the indenture at the time of its creation, with respect to certain transactions that had taken place? These transactions were challenged in the suit. These had been called to the attention of the underwriters before the bond issue was floated and the court found that at that time the parties construed the indenture as authorizing and approving them. Subsequently, in answer to the plaintiff's specific inquiry, the defendant advised plaintiff that the challenged transactions were valid and proper under the indenture and had been so treated. Plaintiff who thereafter purchased his bonds with actual knowledge of the construction could not retreat from the agreed construction of the matter involved. But that is far different from the situation at bar.

American Brake Shoe v. *Interborough Rapid Transit,* 112 Fed. (2) 669 (p. 24), involved a corporate mortgage foreclosure reorganization going on since 1932. Denying discretionary intervention, that court said, that petitioner had "taken an active part in court hearings" and was

"familiar with the situation for years. His application to intervene in September, 1939, can scarcely be deemed timely. * * * Instead of acting promptly, he postponed intervention until a plan of settlement * * * had been drawn upon the assumption that no party to the proceeding was attacking the validity of the pledged bonds". The petitioner was not allowed to retreat. That cannot be compared to the situation at bar.

In *Continental Trust Co.* v. *Toledo,* 82 Fed. 642 (p. 24), Judge Taft upheld the challenger's right to be heard on the validity of a bond issue "after this long delay, after what looks much like laches" (p. 647 of 82 Fed.). "We come now to the alleged irregularity, illegality and fraud set up in these petitions" (p. 653 of 82 Fed.). Two separate mortgages on the Toledo & St. Louis divisions of the Toledo, Cincinnati & St. Louis Railroad Co., a consolidated corporation, were foreclosed in 1885. That corporation, called the old company, must not be confused with the new company, which is the defendant Toledo, St. Louis & Kansas City Railroad Company. The road of the old company was bought by S. H. Kneeland for the first mortgage bondholders of the foreclosed mortgage, subject to a lien indebtedness. Kneeland formed the new company which issued new securities. Owners of new securities issued by the new company challenged the reorganization of the old company affected by Kneeland. The petitioners, owners of new bonds, contended that "the mortgage bonds are void because the contract of January 23, 1886, made between the old bondholders on behalf of the company to be formed, and Kneeland, the contractor was conceived in fraud" (p. 655).

> "It is said that these (new) bonds were issued in pursuance of a corrupt and fraudulent agreement, and that they are, therefore, not valid obligations of the

company. At the time the contract of January 23, 1886, was made, the petitioners had no relation whatever to the company or its incorporators. The debts of petitioners were none of them contracted until 1892 and 1893. The real parties to the contract of January, 1886, were bondholders under the old mortgages. * * *

Disputes arose between Kneeland and the Company which resulted in agreements of settlement before the debts of petitioners were contracted. Now, it may be that these settlements can be set aside by the Company for fraud."

Then follows matter which Philadelphia quotes on page 19. Thus it is clear that the excerpt in Philadelphia's brief is misleading. Judge Taft simply indicated that the owners of securities in the new company could not challenge transactions affecting the old company. But no such situation is here presented.

Graham v. *Railroad,* 102 U. S. 148 (p. 24). The railroad, while solvent, and with no actual intent to defraud creditors, made a voluntary sale of certain lands for an inadequate consideration. Three years later, appellants recovered two judgments against the company on contract indebtedness arising after the sale of the lands.

"The main question is, whether the sale to Nash, made before the Railroad Company became indebted to the appellants, and when for all that appears it was perfectly solvent, * * * can be set aside as the instance of the complainants, for the purpose of subjecting the lands to sale under their execution. And this question we think, must be answered in the negative.

It is a well settled rule of law, that if an individual, being solvent at the time, without any actual intent to defraud creditors, dispose of property, for an inadequate consideration, or even make a voluntary con-

veyance of it, subsequent creditors cannot question the transaction. They are not injured. They gave credit to the debtor in the status which he had after the voluntary conveyance was made" (p. 153 of 102 U. S.).

Palmer v. *Bankers Trust Co.*, 12 Fed. (2) 747 (p. 28), refused to allow a participant to retreat from his position. That case denied a petition for discretionary intervention filed August 2, 1924 (750), after a plan or reorganization had been under discussion for several years" (750) and the plan "approved by three committees of bondholders" had been approved (750). That reorganization was effected in a foreclosure proceeding where it is common to fix an upset price. There the upset "price was fixed by the court, after full opportunity for everyone interested to be heard. Petitioner was invited to participate in the hearing. * * * In view of all the evidence * * * we cannot say that the upset price fixed by the court was too low, nor that the acquiescence therein by the trustee showed bad faith or bad judgment" (754). The right to participate and to be heard in the reorganization proceedings of the debtor at bar is not discretionary but absolute under the Bankruptcy Act.

DeWeese v. *Reinhard*, 165 U. S. 386 (p. 388), involved title to real estate. Mr. Justice Brewer said (p. 388): "All the facts upon which his contention rests are matters of statute and record and any apparent legal title created by them was available in the action to recover possession" (p. 392). "The County records also notified him of the several conveyances and the amount of money paid by the appellees. He was, therefore, simply an intruder." The Supreme Court rejected the contention that the government was a trustee of the lands in question to see that they

should be applied as directed by Congress, his claim being they had been misapplied.

Philadelphia seeks to invoke by analogy the principle of stockholder's derivative or secondary suits. Rule 23(b), FRCP, is a rule of procedure and not of substantive law (*Galdi* v. *Jones,* 2 Cir., 141 Fed. (2) 984; *Goldstein* v. *Groesbeck,* 2 Cir., 142 Fed. (2) 422). The shareholder is only an instigator in the derivative suit. But a suit by either a stockholder or a creditor (bondholder) for the enforcement of his individual right for a recovery to the stockholder or creditor individually for himself and those similarly situated is not governed by the principle of Rule 23(b), FRCP, for it is not a stockholder's derivative suit (*Cohen* v. *Cities Service,* 2 Cir., 45 Fed. (2) 687; *Davidson* v. *Bankers B & M,* 35 F. Supp. 825). In a secondary or derivative suit, recovery runs to the corporation or fiduciary and the benefits of that recovery inure to every stockholder, even one who acquired his stock subsequent to the challenged transaction, and even though he was disqualified to instigate the litigation. Elimination or subordination of Philadelphia will directly affect the public holder such as we are, and not the debtor. The principle of Rule 23(b), FRCP, has no application at bar.

Significantly, Philadelphia's discussion of the Deep Rock rule (pp. 2, 9, 31) says nothing of the well established rule, where, the debts of a subsidiary are to be treated as the debts of the parent.

The Master's fact findings support the allegations in our petition, that, so far as the charter set up is concerned, Philadelphia and Pittsburgh Railways system are a number of separate entities, while in truth and in fact, each of the entities in Pittsburgh Railways system was but a department, agency and instrumentality of Philadelphia. The District Court said:

64 Fed. Supp. 232:

> "In the consideration given to the petition of Jules Guggenheim et al., the Court considered, inter alia, the facts averred in the petition * * *."

Record, page 80-a:

> "There were special reasons for the investigation of the claims of Philadelphia Company. It is the sole stockholder of the Pittsburgh Railways Company, it is the largest creditor and it controls a large majority of the underlying companies."

All public security holders are entitled to full payment of their claims and priority over Philadelphia's claims. Philadelphia's contentions are like Germany's demands for reparations.

II

There is no warrant in the Bankruptcy Act for an examination under Section 21(a) or an investigation under Section 167 of all public holders of notes, bonds, securities or liabilities of the debtor to ascertain when and at what prices these public holders acquired their securities.

In re Prudence Co., Inc. (C. C. A. 2), 88 Fed. (2) 628, 629;

Security-First Nat. Bank v. *Rindge* (C. C. A. 9), 85 Fed. (2) 557, 562; 86 Fed. (2) 3;

In re Fox Metropolitan Playhouse (C. C. A. 2), 74 Fed. (2) 722;

In re Youroveta Home & Foreign Trade Co., Inc. (C. C. A. 2), 288 Fed. 507;

In re Madero Bros., 256 Fed. 859;

The Argument.

In re Horgan (C. C. A. 2), 98 Fed. 414;
In re Chanson (D. C. N. Y.), 20 Fed. Supp. 244;
2 *Collier on Bankruptcy,* 14 ed., p. 281, Sec. 21.11;
Black on Bankruptcy, Sec. 269.

The question is: does the Bankruptcy Act authorize an examination and an investigation of public security holders to ascertain either the consideration paid for their securities, or the time of acquisition, or the knowledge of facts requiring the parent's subordination? The answer is no.

The course which Philadelphia would pursue is not only without statutory justification but in complete disregard of the Bankruptcy Act (compare *In re Steinman,* 3 Cir., 155 Fed. (2) 755 at 759).

Since Philadelphia's applications rest on Section 21(a) and Section 167 of the Bankruptcy Act, its applications must fall, unless authorized by the statute. Hence the judicial eye must ascertain whether or not the proposed inquiry is relevant or material to matters within the scope of Sections 21(a) and 167. It is not.

While Section 21(a) is limited to the "acts, conduct and property of the bankrupt", Section 167 extends to the "acts, conduct, property, liabilities and financial condition of the debtor and the operation of its business" (sub. 1), to "directors and officers of debtor" (sub. 2), to "fraud, misconduct, mismanagement and irregularities and to causes of action available to the estate" (sub. 3). In clear and unmistakable language Section 167 provides for an investigation of corporate management-fiduciaries.

Nothing in Philadelphia's moving papers either directly or indirectly charges or suggests that the public security holders proposed to be examined or investigated, were directors or officers or formed any part of the management

of debtor or of underliers or are charged with fraud, misconduct or mismanagement against the debtor or against any underlier or that any cause of action is available to the estate against any such public security holder.

Philadelphia has not denied the allegations of our petition which states, inter alia,

> "Philadelphia Company officered and financed the debtor and underliers."

Denying a Section 21(a) examination, Circuit Judge Learned Hand, then a District Judge, in *In re Madero Bros.*, 256 Fed. 859, at page 860, said:

> "The question rather is whether the examination concerns 'the acts, conduct and property of the bankrupt'; for, if it does not, then it is not authorized."

The cost to public holders of their securities, and the time when same was acquired, or their knowledge of Philadelphia's conduct of debtor, are not even remotely suggested as a subject of inquiry under these sections.

What the public holders paid for their claims, and, when, where and why they purchased, do not concern the acts of the debtor, the conduct of the debtor, or the property of the debtor, or the debtor's liabilities. The word "liabilities" has reference to liabilities of the debtor (*In re Security First National Bank* v. *Rindge,* 9 Cir., 85 Fed. (2) 557). These are private affairs of non-fiduciaries not subject to inquiry (2 Collier on Bankruptcy, 14 ed., p. 281, Sec. 21.11). In reality what is sought is an inquiry into the conduct and private business of public security holders and not the affairs of debtor. This cannot be done (*In re Prudence Co.,* 2 Cir., 88 Fed. (2) 628, 629). Philadelphia's proposed investigation is clearly not "to protect creditors, particularly from possible machinations of those who owe a

fiduciary duty. There is no fiduciary obligation between a creditor and a debtor" (*Security-First Nat. Bank* v. *Rindge,* 9 Cir., 85 Fed. (2) 557, 562).

In re Fox Metropolitan Playhouse, Inc., 2 Cir., 74 Fed. (2) 722, denied an application by creditor for a Section 21(a) examination of the members of the two banking firms who had dealt in the corporation securities. The court said:

> "As the petition is drawn, it is apparent that the petitioner desired to make inquiry not into the 'acts, conduct or property of a bankrupt whose estate is in the process of administration,' but rather into * * * the manipulations or conduct of the members of the noteholders' protective committee."

"In general, a large latitude of inquiry should be allowed in the examination of persons closely connected with the bankrupt in business dealings or otherwise, for the purpose of discovering assets and unearthing frauds, upon any reasonable surmise that they have assets of the debtor" (*In re Foerst* (D. C. N. Y.), 93 Fed. 190, 191). The record is clear that Philadelphia alone falls in that category.

Section 21(a) requires the order be for a "designated person". How would Philadelphia reach public security holders who have not disclosed their identity by failing to file a claim? How can their examination be ordered in the face of Section 21(a)? The securities of debtor and of underliers are and have been publicly traded in for many years. Thus the statutory requirement for a designation precludes the John Doe "fishing excursions" sought by Philadelphia.

The Bankruptcy Act at Section 41(a) (11 U. S. C. A. 61) provides that no person shall be required to attend a place

outside the State of his residence, and more than 100 miles from such place of residence. The security holders are so widely scattered that some may reside in every state of the United States and in foreign countries. Some of our Federal courts have more than one district, others have divisions as well. The great state of Texas spans 1,000 miles. Is this long drawn out reorganization to be turned into a countrywide—yes, worldwide— goose chase, with a separate inquiry in every hamlet?

Though the order of November 7, 1945, directed the trustee to conduct an examination under Section 21(a) of the Bankruptcy Act, and though Section 21(a) of the Bankruptcy Act contemplates oral testimony under oath, the Trustee has not examined Philadelphia or any witness.

If the Court were to grant the relief sought by Philadelphia, the public holders may dump their securities on the market, rather than he subjected to examination and investigation. That would break the market and would enable Philadelphia to pick up the public securities at a fraction of their face amount. What a bonanza that would be for Philadelphia. The court's protective umbrella would close and become a stiletto to stab the public security holders.

The purpose of the Bankruptcy Act is to protect creditors (*Security-First Nat. Bank* v. *Rindge Land & Navigation Co.*, 9 Cir., 85 Fed. (2) 557).

III

That there is no conflict of decision on the point in issue is clear from Point I.

IV

The questions presented by Philadelphia are not of sufficient importance to require review by this Court.

Philadelphia's crocodile tears, at bar, like those of its parent in *Standard Gas & Electric* v. *Deep Rock,* 10 Cir., 117 Fed. (2) 615, 619, may well be compared to those of the Queen in her efforts to destroy Snow White.

CONCLUSION

It is respectfully submitted that Philadelphia's petition for certiorari should be denied.

Respectfully submitted,

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INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statement	3
Statutes involved	6
Argument	7
Conclusion	18

CITATIONS

Cases:

American United Mut. Life Ins. Co. v. *City of Avon Park*, 311 U. S. 138	11
Celotex Co., In re, 12 F. Supp. 1	11
Godfrey v. *Powell*, 150 F. 2d 486	16
Indiana Central Telephone Co., In re, 24 F. Supp. 342	11
Lorraine Castle Apartments Building Corp., In re, 149 F. 2d 55 certiorari denied, 326 U. S. 728	11, 12, 14
McEwen's Laundry, In re, 90 F. 2d 872	11
Midland United Co., In re, 58 F. Supp. 667	16
Mississippi & Missouri R. Co. v. *Cromwell*, 91 U. S. 643	16
Missouri Pac. R. Co., In re, 64 F. Supp. 64	16
Mokava Corp. v. *Dolan*, 147 F. 2d 340	11, 12
Phelan v. *Middle States Oil Corp.*, 154 F. 2d 978	13
Philadelphia Co. v. *Dipple*, 312 U. S. 168, affirming In re Reorganization of Pittsburgh Railways Co., 111 F. 2d 932	3
Philadelphia Co. v. *S. E. C.*, No. 9513, App. D. C., now pending	3
Pittsburgh Railways Co., In re, 117 F. 2d 1007	3
Pittsburgh Railways Co., In the Matter of, 155 F. 2d 477, certiorari denied, *In the Matter of Pittsburgh Railways Co., Philadelphia Co., et al.* v. *Guggenheim et al.*, Nos. 359–364, October Term, 1946	3
Point Building Land Co., In the Matter of, 37 A. B. R. (N. S.) 464	11
Randolph v. *Quidnick Co.*, 135 U. S. 457	16
Security-First Nat. Bank v. *Rindge Land and Navigation Co.*, 85 F. 2d 557, certiorari denied, 299 U. S. 613	11
Standard Gas & Electric Co. v. *Deep Rock Oil Corp.*, 117 F. 2d 615, certiorari denied, 313 U. S. 564	9, 10
Taylor v. *Standard Gas & Electric Co.*, 306 U. S. 307	9
Utilities Power and Light Corp., In re, 29 F. Supp. 763	11
Young v. *Higbee*, 324 U. S. 204	17

Statutes:

	Page
Bankruptcy Act, Chapter X (11 U. S. C. 501):	
Section 21 (a) (11 U. S. C. 44 (a))	4, 6, 8
Section 167 (11 U. S. C. 567)	4, 6, 8
Section 208 (11 U. S. C. 608)	6
Miscellaneous:	
Sprecher, *The Conflict of Equities Under the "Deep Rock" Doctrine*, 43 Columbia L. R. 336 (1943)	13

In the Supreme Court of the United States

OCTOBER TERM, 1946

IN THE MATTER OF PITTSBURGH RAILWAYS COMPANY, DEBTOR

No. 1178

PHILADELPHIA COMPANY, PETITIONER

v.

JULES GUGGENHEIM, ET AL.

No. 1179

PHILADELPHIA COMPANY, PETITIONER

v.

JULES GUGGENHEIM, ET AL.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the district court on the motion filed November 23, 1945 (R. 27–29), is reported at 64 F. Supp. 231. The opinion of the

district court on the petition filed March 6, 1946 (R. 77–81), has not been reported. The opinion of the circuit court of appeals (R. 85–90) is reported at 159 F. 2d 630.

JURISDICTION

The orders of the circuit court of appeals were entered on December 31, 1946 (R. 91–92). The petition for writs of certiorari was filed on March 29, 1947. The jurisdiction of this Court is involved under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1935, made applicable here by Section 121 of Chapter X of the Bankruptcy Act (11 U. S. C. 521).

QUESTION PRESENTED

The reorganization court had ordered an investigation into causes of action against the debtor's parent company, petitioner herein, and into grounds for the subordination or limitation of its claims. The parent company urged that an investigation be made into the identity of the debtor's public security holders and into the time and cost of their acquisitions. Petitioner alleged no breach of fiduciary obligation or other misconduct, but only that many of their purchases were made during the reorganization, at discounts under par, and with notice of grounds asserted for subordinating or limiting the parent company. Petitioner also contended that establishment of these facts would justify subordination or limitation of the claims of such petitioners

or the mitigation or avoidance of subordination or limitation of the claims of the parent.

The question is whether the court below correctly held the asserted facts to be irrelevant and properly affirmed the district court's refusal to order the investigation of the public security holders.

STATEMENT

The case involves judgments in two appeals made in proceedings under Chapter X of the Bankruptcy Act for the reorganization of Pittsburgh Railways Company, the debtor. Philadelphia Company, the petitioner, is a holding company in the Standard Gas & Electric system. It is the parent of the debtor and of most of the so-called underlier companies comprising the debtor's street railway system and is also a substantial creditor of the debtor and many of the underliers (R. 18). The reorganization proceedings for the street railway system have been pending for nine years, since May 10, 1938, and various steps therein have been the subject of extensive litigation.[1]

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[1] *Philadelphia Company* v. *Dipple*, 312 U. S. 168, affirming *In re Reorganization of Pittsburgh Railways Co.*, 111 F. 2d 932 (C. C. A. 3); *In re Pittsburgh Railways Co.*, 117 F. 2d 1007 (C. C. A. 3); *In the Matter of Pittsburgh Railways Co.*, 155 F. 2d 477 (C. C. A. 3), certiorari denied *sub nom. In the Matter of Pittsburgh Railways Co., Philadelphia Company et al.* v. *Guggenheim et al.*, Nos. 359–364, this Term (October 14, 1946); *Philadelphia Company* v. *Securities and Exchange Commission*, now pending in the U. S. Court of Appeals for the District of Columbia.

Guggenheim et al., public security holders of the debtor and several underliers (R. 34), filed a petition requesting an investigation under Sections 21 (a) and 167 of the Bankruptcy Act, 11 U. S. C. 44 (a) and 567, into possible claims or causes of action available to the estate against Philadelphia Company or any other party, and into grounds for the subordination or equitable limitation of claims filed by Philadelphia Company (R. 15). On November 7, 1945, the district court refused Philadelphia Company's motion to dismiss; did not adopt its suggestion that, if an investigation be ordered as to it, "a similar investigation should be made with respect to the claims of all creditors" (R. 16, 22–23, par. (4)); and directed the trustee to conduct the investigation prayed for (R. 19–21). No appeal has been taken from this ruling and the investigation has since proceeded as ordered.

Philadelphia Company, the petitioner herein, thereafter took two steps.

1. It moved to amend this order so as to have the inquiry relate not only to itself but to all holders of the securities and liabilities of the debtor, including public holders, whether or not they filed claims on their holdings (R. 21–23). It urged that members of the public had bought large amounts of the debtor's securities during the reorganization at low prices; that these purchases were made when the question of Philadelphia Company's subordination by reason of its pre-

vious conduct respecting the debtor had been raised; that the market prices of the securities had gone up substantially since the inception of the proceedings; that any further enhancement by reason of Philadelphia Company's subordination might result in the "unjust enrichment" of such purchasers; that these facts, if established, warranted the court in denying them the benefits, in whole or in part, of any subordination or limitation of Philadelphia Company's claims, or in subordinating the claims of these security holders; and that the court should therefore order an inquiry into the identity of the public security holders and the time and cost of their purchases (R. 68, 71–73; see also Pet. 6–7). The district court held that the showing of facts made by petitioner was inadequate to warrant adding to the subject of the investigation the matters urged by petitioner and it denied the motion, though in effect without prejudice to its later renewal on a proper showing of facts (R. 27–29).

2. Shortly after filing a notice of appeal from this order, Philadelphia Company presented a petition, which, after reciting the identical substantive facts and conclusions that it had previously urged upon the court in support of its rejected motion, prayed for the identical relief—the expansion of the investigation in the respects set forth above. The district court, after hearing petitioner and various objecting parties (R. 51–71), determined that it would not receive

evidence offered by Philadelphia Company in support of the aforesaid disputed factual allegations (R. 71, 76), and subsequently dismissed the petition, again without prejudice (R. 81).

The circuit court of appeals affirmed the two refusals of the district court to order the requested investigation (R. 91–92).

The Securities and Exchange Commission, pursuant to Section 208 of the Bankruptcy Act (as added by the Act of June 22, 1938, c. 575, § 1, 52 Stat. 894, 11 U. S. C. 608), is a party to the proceedings for the reorganization of Pittsburgh Railways Company, debtor, under Chapter X of the Bankruptcy Act in the District Court for the Western District of Pennsylvania and was an appellee in the court below.

STATUTES INVOLVED

Bankruptcy Act, Section 21 (a), 11 U. S. C. 44 (a):

> The court may, upon application of any officer, bankrupt, or creditor, by order require any designated persons, including the bankrupt and his or her spouse, to appear before the court or before the judge of any State court, to be examined concerning the acts, conduct, or property of a bankrupt * * *.

Bankruptcy Act, Chapter X, Section 167, 11 U. S. C. 567:

> The trustee upon his appointment and qualification—
>
> (1) shall, if the judge shall so direct,

forthwith investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan, and report thereon to the judge;

(2) may, if the judge shall so direct, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters or any of them;

(3) shall report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate; * * *

ARGUMENT

The question presented involves efforts of Philadelphia Company, after unsuccessfully attempting to escape an investigation into its management of the debtor, its subsidiary, to add thereto an investigation into public holders of the debtor's securities and holders of its other liabilities. In our view the holding below was clearly correct and presents no conflict with the rulings in other circuits or with any decision of this Court.

The circuit court of appeals held that the facts that purchases had been made at a discount, during the reorganization, and with notice of wrongdoing by Philadelphia Company were irrelevant, because, even if established, they did not, in the

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absence of fraud or other misconduct, subject the public purchasers to subordination or bar them from benefiting through the subordination of Philadelphia Company (R. 89–90). It held, therefore, that the identity of public security holders and the time and cost of their acquisitions were immaterial to any issue in the reorganization, and that consequently, there was no basis for inquiring into them. For while the trustee's investigatory powers in reorganization proceedings are undoubtedly broad, they may not transcend the limits specified by statute. Section 21 (a) of the Bankruptcy Act (11 U. S. C. 44 (a)) limits the scope of the examination to "the acts, conduct, or property of a bankrupt * * *," while Section 167 (11 U. S. C. 567), the other provision under which the expanded examination is here sought by the party being investigated, specifically requires the trustee's investigatory powers to be exercised with respect to "any * * * matter relevant to the proceeding or to the formulation of a plan * * *" Section 167 (1). The requested expanded investigation does not relate to the acts, conduct or property of the bankrupt; consequently, unless it is relevant to the proceeding or plan formulation, there is no statutory basis for it.

It is clear that the subject matter sought to be injected into the investigation is irrelevant to the statutory objective. In the absence of fraud, misconduct or breach of fiduciary obligation, secu-

rities of a debtor corporation purchased by public investors at a discount during the reorganization are not, for these reasons, subject to subordination, nor is the distribution to such purchasers affected by the circumstance that they had knowledge of grounds for subordination of another holder of the debtor's securities.

In *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, this Court held that Standard was to be subordinated on its claims against its subsidiary in reorganization, Deep Rock Oil Corporation. Public trading in Deep Rock's securities had continued when the question of subordination was first raised, while it was being litigated, and when the issue was adjudicated adversely to Standard. Public purchasers of Deep Rock securities during this period undoubtedly were on notice of the question of subordination and undoubtedly knew of this Court's decision (cf. R. 87). On Philadelphia Company's theory here, grounds existed for subordinating or limiting their claims. And on remand to the district court, Standard, advancing this theory, requested an inquiry into their acquisitions similar to that sought here. The district court refused, and was affirmed by the circuit court of appeals. *Standard Gas & Electric Co.* v. *Deep Rock Oil Corporation,* 117 F. 2d 615 (C. C. A. 10), certiorari denied, 313 U. S. 564.

The circuit court of appeals said (117 F. 2d at 619):

> In the order of July 24, 1940, the [district] court found that it would be impracticable to require the holders of securities to file statements showing the prices paid therefor, due to the number of securities outstanding and the extent of public dealing therein. There is no showing that this finding is not fully justified. Furthermore, the filing of such statements would not have benefited Standard. In the absence of fraud, the prices which security holders pay for their securities do not affect the measure of their participation under the plan of reorganization.[2]

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[2] Philadelphia Company's attempted distinction of the *Standard Gas* case (Pet. 31) is insubstantial. (a) No distinction can be inferred from the fact that in that case only the cost to public holders was sought to be ascertained while here time of acquisition and identity are added factors. Clearly an inquiry into cost would have required an identification of the security holders who purchased. As to time of acquisition, the decision in the *Standard Gas* case obviously related to discount purchases both before and during the proceedings and thus comprehended rather than excluded the scope of inquiry here sought by Philadelphia Company. (b) The circuit court of appeals in the *Standard Gas* case based its refusal to inquire into costs to public security holders squarely on the irrelevancy of the inquiry. The irrelevancy is not diminished, as Philadelphia Company suggests, because the inquiry is here requested before rather than after an adjudication that the parent be subordinated on its claims. (c) This court in deciding that Standard Gas should be subordinated to the public security holders of its subsidiary, had had before it no contentions with respect to the costs of acquisition by individual public security holders and accordingly the issue in respect of which Standard sought the inquiry on remand had not been foreclosed.

This holding is the uniform rule in reorganization. Unless special circumstances appear which are not here alleged—e. g., a fiduciary relationship by a security holder to a debtor,[3] dealings with a fiduciary, access to inside information, fraud, and the like—purchasers of securities at a discount during the reorganization are entitled to participate on a parity with other holders. *In re Lorraine Castle Apartments Building Corp.*, 149 F. 2d 55 (C. C. A. 7), certiorari denied, 326 U. S. 728; *Mokava Corporation* v. *Dolan*, 147 F. 2d 340 (C. C. A. 2); *Security-First Nat. Bank* v. *Rindge Land and Navigation Co.*, 85 F. 2d 557 (C. C. A. 9), certiorari denied, 299 U. S. 613; *In re Utilities Power and Light Corp.*, 29 F. Supp. 763, 770 (N. D. Ill.); *In re Indiana Central Telephone Co.*, 24 F. Supp. 342, 344 (D. Del.); *In the Matter of Point Building Land Company*, 37 A. B. R. (N. S.) 464, 466 (W. D. Pa); *In re Celotex Co.*, 12 F. Supp. 1, 5 (D. Del.).

As the *Lorraine Castle* case shows, a primary consideration in the consistent refusal of the courts, absent special circumstances, to subordi-

[3] This is the case with Philadelphia Company, but has not been alleged with respect to the public security holders. *American United Mut. Life Ins. Co.* v. *City of Avon Park*, 311 U. S. 138, and *In re McEwen's Laundry*, 90 F. 2d 872 (C. C. A. 6), cited by Philadelphia Company as justifying an inquiry into the cost of acquisition of the debtor's securities by security holders generally (Pet. 28–29), actually relate only to the cost to security holders occupying a fiduciary relationship to a debtor.

nate or limit purchasers at a discount during reorganization, is the preservation of the marketability of securities of debtor corporations. 149 F. 2d at 57–58. If the acquisition of such securities would subject the purchaser to the subordination or limitation of his claim, the price he paid would become the maximum he could obtain in distribution, and he might well receive less. In the face of such an unremunerative prospect, purchases of securities affected by a reorganization would be discouraged and the marketability of reorganization securities would be seriously curtailed if not completely destroyed. Those directly injured by such a rule would be the investors who acquired their holdings when the enterprise was solvent. With the disappearance of purchasers upon the commencement of the reorganization, or more probably on the first faint rumors of its possible approach, they would remain with no alternative but to hold on to an unmarketable security of declining value. As was pointed out in *Mokava Corporation* v. *Dolan, supra,* 147 F. 2d at 344–345:

> To reduce a creditor's participation in the plan to the amount he paid for his bonds (except in unusual circumstances not present here) would be harmfully to reduce the value of such bonds to those who previously owned them.[4]

[4] That indiscriminate injury would be a consequence of limiting purchasers during a reorganization to cost or of subordinating them appears to have been overlooked in

Nor is force added to Philadelphia Company's contentions by the assertion that the facts it seeks to have investigated are necessary to enable it "to prepare a defense to the charges [of mismanagement] made against it" (Pet. 9). The issues of mismanagement are now under investigation by the trustee pursuant to statute. A proper defense to such charges would be evidence of faithful management by Philadelphia Company. We do not observe any relevance in the circumstances of purchases by members of the public or their identity to the question of the fidelity of Philadelphia Company's management of the debtor. To the extent that "fair and equitable" treatment of publicly held securities may be affected by proof of its wrongdoing, Philadelphia Company is in no way prejudiced by profits resulting from purchases and sales within the class of public owners of those securities.[5] If, on the other hand, as Philadel-

Sprecher, *The Conflict of Equities Under the "Deep Rock" Doctrine* (1943) 43 Col. L. Rev. 336. It should be noted also that the conclusions of the article which are cited by Philadelphia Company (Pet. 21, 22) lack judicial support and are directly contradicted by the authorities that it discusses. See 43 Col. L. Rev. at 346, esp. notes 32 and 34.

[5] See *Phelan* v. *Middle States Oil Corp.*, 154 F. 2d 978, at 1001 (C. C. A. 2): "It is suggested that a purchaser (such as Cohen) should have no right against a receiver because otherwise the purchaser will acquire a windfall, since he, like the seller, knew nothing of that right when he purchased. But in a great variety of instances, purchasers are permitted to acquire windfalls, e. g., a buyer of land on which oil is discovered after the sale. The Restatement of Contracts, § 171 (2) reads: 'Unless otherwise provided in the assignment or

phia Company contends, members of the public who have acquired those securities in the course of the reorganization may have suspected such wrongdoings when they made their acquisitions, this factor presumably affected the prices they paid, and they should receive the benefits if the alleged wrongdoing of petitioner is substantiated.[8] Furthermore, if Philadelphia Company, through its contentions here, should be permitted to escape or reduce the subordination or limitation of its claims or to avoid causes of action against it even if its misconduct should be established, the result would be a totally undeserved windfall to a faithless fiduciary. This is a type of windfall that no court of equity should permit.

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by agreement of the assignee with the assignor or with the obligor, an assignee under an effective assignment for value has the same right to any securities for the assigned right that were available to the assignor, though he has not bargained for them, as if the assignor had agreed to transfer them.' If Glass [the receiver] was guilty of wrongdoing, that Cohen's estate will unexpectedly benefit can work no harm to Glass."

[8] *In re Lorraine Castle Apartments Building Corporation*, 149 F. 2d 55, 57–58 (C. C. A. 7): "To reduce the participation to the amount paid for securities, in the absence of exceptional circumstances which are not present here, would reduce the value of such bonds to those who have them and want to sell them. This would result in unearned, undeserved profit for the debtor, destroy or impair the sales value of securities by abolishing the profit motive, which inspires purchasers. This is even more evident when the purchaser acquires a lawsuit when he buys a debt. He hopes to realize more than he pays and at the same time runs the risks of recovering less."

Another consideration bearing upon the appropriateness of the added investigation sought by petitioner is the fact that in undertaking it the trustee would face overwhelming difficulties. As the Circuit Court of Appeals said (R. 89):

> The task of the trustee examining into all the bondholders of Pittsburgh Railways would be enormous. A large number of them have not filed individual claims. Under the District Court order of July 22, 1938 and Section 198 of Chapter 10 of the Bankruptcy Act this is not necessary unless they wish to vote on a reorganization plan. The debtor's bonds are widely held. They are on the open market and subject to changes of ownership. This might well result in some part at least of the proposed investigation being rendered useless. Viewed in the light of this complex, long drawn out reorganization, objection to such investigation as impractical would seem to have considerable merit despite appellant's offer to produce evidence to the contrary.

Indeed, if this effort by Philadelphia Company to have the trustee embark on an extensive inquiry into irrelevant facts had been successful, it would have served Philadelphia Company by diverting the trustee from his task of inquiring into acts of mismanagement by Philadelphia Company, and it would moreover have the mischievous effect of harassing the public security holders, and of adding still further to the numerous delays that have beset this proceeding.

None of the cases relied on by Philadelphia Company involve any conflict with the decision below. It is true that in a number of cases the courts have referred disparagingly to the motives of security holders who bought into a proceeding, especially where they bought in at low prices. But even in those cases, the courts have uniformly passed upon the merits of the security holders' contentions, and disposed of them on other grounds. *Godfrey* v. *Powell,* 150 F. 2d 486 (C. C. A. 5); *In re Missouri Pac. R. Co.,* 64 F. Supp. 64 (E. D. Mo.); *In re Midland United Co.,* 58 F. Supp. 667, 681 (D. Del.).

The two decisions of this Court cited by Philadelphia Company were in equity proceedings which in effect tried title to securities which, although acquired under dubious circumstances, would have yielded the complainants a huge speculative profit if equitable relief were granted. *Randolph* v. *Quidnick Co.,* 135 U. S. 457; *Mississippi & Missouri R. Co.* v. *Cromwell,* 91 U. S. 643. Refusal of relief in such cases is no authority for permitting the introduction of added subjects of investigation here, where, even if all of petitioner's factual allegations were true, no irregularity appears in the purchases by the public security holders, and where a reduction in distribution to public security holders by reason of the lateness

of their purchases would injure not only the recent purchasers but also long time investors. We are aware of no case, and petitioner has cited none, which permits such a result.[7]

It is thus clear that, even if the court should order the investigation prayed for by Philadelphia Company, learn the identity of each of the debtor's public security holders and the time and cost of his acquisition, and establish that some of them or many of them had, in fact, bought at a discount during the pendency of the proceeding and with knowledge or notice of grounds asserted for the limitation or subordination of Philadelphia Company's claims, all such information would be irrelevant to the issue as to whether to subordinate or limit the claims of such public holders, since they are not to be subordinated or limited for these reasons, nor is the extent of Philadelphia Company's subordination or limitation thereby to be reduced or avoided. Accordingly, the court below correctly affirmed the denial by the reorganization court of the application of petitioner.

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[7] The implication of petitioner that the expanded investigation is justified because the initial inquiry into Philadelphia Company was at the request of a security holder with an alleged questionable motive is immaterial even if true, for the inquiry into Philadelphia Company is for the benefit of all public security holders. *Young* v. *Higbee*, 324 U. S. 204, 214.

CONCLUSION

For the foregoing reasons, the petition for certiorari should be denied.

Respectfully submitted.

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APRIL 1947.

U. S. GOVERNMENT PRINTING OFFICE: 1947